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Corporate Contributions Outlook, 1984

by Anne Klepper and others

The Conference Board

THE CONFERENCE BOARD'S 1984 CORPORATE CONTRIBUTIONS OUTLOOK PANEL

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Corporate Contributions Outlook, 1984

Corporate contributions increased nearly tenfold during the last three decades—from $343 million in 1951 to just under $3 billion by 1982. Contributions moved up and down with corporate pretax income—except in the early 1980's when, in three successive years of falling income, corporate contributions continued to climb.[1] This poses several questions: Will contributions resume their lockstep with profits, or is a new pattern emerging? If there is a new pattern, what are its underlying characteristics?

To help explore these basic questions, The Conference Board assembled a 14-person panel to examine the future of corporate contributions.[2] Most of the panelists were senior personnel from "leading edge" companies in contributions, companies that have established a track record of outstanding programs and sound practice in this field. Other panelists were specialists in other fields, (e.g., economics, public relations) selected to bring expert analyses to the meeting. Attention was directed to the message from the crystal ball, not to the nuts and bolts of managing corporate contributions programs.

The overall message was clear: The corporate contributions function has come of age. No longer viewed as an odd, somewhat peripheral corporate activity, corporate contributions have grown in value and effectiveness and are seen as addressing complex issues that impinge directly on the business environment. The function is being institutionalized in the corporate structure, and increasingly, is being integrated into the corporate strategic plan. Multimillion-dollar contributions programs require detailed planning, focused programs, stated and agreed-upon priorities, and sound budgeting. At present, these programs are managed by a cadre of executives, most of whom have been seasoned in other parts of the corporate structure.

Panelists agree that increased attention is being directed to programs at the community level—not at the expense of national programs in place at corporate headquarters but as an additional area of prime activity. The panel views community-needs assessment as a useful tool for corporations planning to target their giving. In addition to contributions, varied corporate resources (such as personnel, purchasing, product, printing, loans, space, facilities, etc.) are being tapped as a means of extending the company's social reach.

No more than a decade ago, corporations preferred to maintain the lowest of low profiles: They virtually went underground regarding their contributions and allied social-assistance activities. Now, they have made a 180-degree turn. All communications media are being used to reach a variety of audiences—employees, shareholders, community leaders, donees and national opinion leaders.

What factors have led to the maturation of the social-assistance function, and how will these factors interact in the days ahead? The panelists addressed the several facets of this question.

A.N. SCALLON
Director, Corporate Support Programs
IBM Corporation
Armonk, New York

A.N. Scallon, who opened the session, observed:

> "The very fact that we are taking the time to consider the future is indicative of the professionalization that is taking place in what was formerly a rather 'ad hoc' business activity.
>
> "I, personally, believe there are two basic tenets in the field of corporate contributions. First, we must be sure that any contribution we make is in our corporate interest, or how can we justify it? Second, we must assure that the corporate interest overlaps both the interest of the recipient institution and the public interest.
>
> "Also, we should not just consider IRS-defined charitable contributions. We should tally everything that falls under the umbrella—cash, loaned personnel, product and equipment. In the beginning, it may take a lot of work to gather this information on a companywide basis, but it will pay off.
>
> "I think we have to view international contributions as a new frontier. Overseas, our corporate-responsibility objectives are much the same as in the United States—to be a good citizen of every country in which we do business—and, generally, to enhance our reputation. We can send a message to the host countries about corporate responsibility and enlightened business behavior of U.S. corporations. It can help the American corporation become less of an outsider."

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[1] Corporate pretax income dropped from $235 billion in 1980 to $174 billion in 1982. Corporate contributions climbed from $2.4 billion to just short of $3 billion in that period. Kathryn Troy, *Annual Survey of Corporate Contributions, 1984 Edition*. The Conference Board, Report No. 848, 1984.

[2] See page 2 for titles and corporate affiliations of the panelists.

Evolution of a Function

The "keynoter," Waldemar A. Nielsen, was "very bullish" about the future for corporate philanthropy, not just in terms of increased scale but also in terms of the effectiveness of such aid. Prior to 1969, he saw philanthropy as "sluggish, smug, with little interaction and serious discussion of professional problems. It was a little group of people wrapped in mythology and self-righteousness." Some panelists believe the Patman hearings, and the subsequent Tax Reform Act of 1969, shocked them out of such attitudes—completely and forever. (See box below.)

WALDEMAR A. NIELSEN
Waldemar A. Nielsen Incorporated
New York, New York

Now, research is being conducted on foundations and the whole nonprofit sector, complex issues are being addressed, and lively discussions take place in many settings. And the corporate contributions function is at the forefront of these developments. Said Nielsen:

> "Today, you are the most dynamic part of philanthropy. By nature, I'm a melancholy Scandinavian, but not here. Philanthropy is just at the beginning of its most creative period."

Changing the Foundations

In the early 1960's, Texas Congressman Wright Patman, Chairman of the Select Committee on Small Business, launched a series of hearings on foundation practices.[1] At these hearings (and in subsequent reports), certain financial abuses and structural faults were identified for some foundations. These involved close ties among foundations, donor families, and associated companies; the use of foundation assets to control corporations; and minuscule grant programs. Patman's work was a major factor in the passage of the Tax Reform Act of 1969, which contained many detailed provisions regulating foundations, including mandated payout levels, restrictions on self-dealing, and requirements for disposition of excess business holdings.

[1] Hearings before the House Subcommittee, Select Committee on Small Business, 1964, 1966, 1967, 1968. Tax Reform Act of 1969, December 30, 1969.

Strengthening the Institutional Structure of Corporate Contributions

(1) Educate and involve directors and committee members in the problems that corporate philanthropy has to address. Bring in leading, interesting people to talk about problems like housing or youth employment—topics of real relevance. Maintain an educational activity at all times.

(2) Add an outside director of real stature to the foundation board [or contributions committee] if one is not already there. This will have a powerful effect in broadening and enriching the discussions.

(3) Create a group of officers to screen proposals for the board or contributions committee. Get senior-status people who understand what the function is and what it is doing. This will build a base of understanding and support for the program throughout the company. This is the finest experience a corporation can provide to equip senior executives to deal with the external world.

(4) Encourage employee gift matching to democratize corporate charitable contributions. Passing out corporate dollars purely at the discretion of a tiny group of senior officers is no longer going to be accepted. A rough but useful giving formula might be one-third by district managers, one-third by senior officers at headquarters, and one-third by employee-driven programs [such as matching gifts, and grants to organizations that employees serve as volunteers].

(5) Collaborate with other foundations and corporations in addressing large and complex problems. Some of the problems are very intimidating, such as health-care costs, employment of minority youth, and safety of nuclear reactors. We do not want to see government as the single source addressing these problems. We are coming alive intellectually in the field of philanthropy.

Source: Excerpted from remarks by Waldemar A. Nielsen at The Conference Board's 1984 Workshop on "The Future of Corporate Contributions."

However, there are certain structural problems that corporate-contributions executives must deal with, and the institutional structure of the function must be developed and strengthened. Nielsen made several recommendations to improve the institutional structure of a corporate contributions program. (See box above.) Among his suggestions, Nielsen's most controversial observation was that one-third of corporate giving be done through employee-driven programs. The corporate world is strongly divided on this issue. Some maintain that the future trend is toward greater employee participation in all aspects of corporate life and that matching gifts, employee volunteer-service grants, and similar programs represent a democratization of the contributions function. Others point out with equal conviction that such programs have resulted in skewed budgets, support of questionable institutions, cases of fraud, and a sharp reduction in dollars available for pressing human needs. In fact, Conference Board information shows that major companies (where matching-gift programs have exceeded the 30 percent mark) have now taken measures to cap such expenditures.

The Economic Outlook

The state of the economy is obviously a major concern and prime influence in corporate contributions. But there are other influences as well. As asked earlier, what accounted for the early 1980's profile of falling income and rising contributions?

The stabilizing influence of company foundations was one factor. For three successive years, (1980, 1981, 1982), company foundations paid out more than they received in grants from their parent corporations. By 1982, company foundations gave away 45 percent more than they received.[3] This is a situation that, obviously, cannot long continue. Virtually no company foundations are able to live off investment income. Unless company foundations receive annual or intermittent (every second, third or fourth year) infusions of funds from their corporations, their resources will soon be exhausted.

ALBERT E. DePRINCE, JR.
Senior Vice President and
Chief Economist
Marine Midland Bank
New York, New York

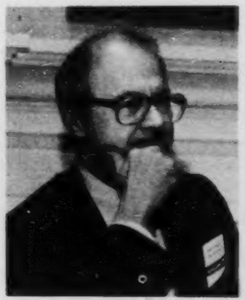
Fortunately, 1983 was a year of recovery and both company foundations and direct-giving programs were able to look forward to increased dollar resources. Moreover, the future economic outlook is seen as bright. Albert DePrince brought the panelists a good-news economic forecast and saw slim chance of a doomsday scenario. He predicted that the massive federal budget deficit would be addressed, and that the "new sense of urgency" in Washington would bring reductions in the deficit of $100-$150 billion in the next two years.

Dr. DePrince sketched the following scenario:

> "The last year itself has been quite surprising. We are now in the 15th month of business expansion, a business expansion that was totally unanticipated in its strength. At the federal level, a restrictive monetary policy and stimulative fiscal policy neutralized each other, and a normal cycle unfolded. That is the prospect for 1984 and 1985. In 1983, GNP rose 6.1 percent, hardly different from the typical post-World War II recovery. This year, GNP should go up 4½-5 percent, with a 3½ percent rise in 1985, and stalemate in 1986. Inflation should be about 8 percent in 1986, higher than the 4 percent in 1983 and the core rate of 5½ to 6 percent.
>
> "There are serious challenges to all firms. First, companies will guard their expenses to insure corporate survival. There will be continued cost control and cost cutting. Second, there are the gargantuan federal deficits, for which the perception is probably more important than the fact. What could suddenly go wrong to give us a doomsday scenario? If interest rates zoomed, if there were an economic or financial crisis, if the financial markets telescoped their actions, there could be a stampede.
>
> "But the mood in Washington shows a new sense of urgency to do something about the deficit. The numbers are sufficiently gigantic to have set in place a certain fear. I think we are at the first stage of a $100 to $150 billion cut in the federal deficit in the next two years (40 percent through tax increases, 60 percent through spending cuts—of which 65 percent might be in defense."

The Institutionalization of the Contributions Function

A second major stabilizing factor in the corporate contributions picture has been the institutionalization of the function. It has "jumped out of the CEO's hip pocket" into the body of the corporation. Greater acceptance by senior management, greater emphasis on planning, and greater application of management techniques to contributions programs have marked this gradual and continuing transition.


RONALD F. GILRAIN
Vice President, Public Affairs
The Stanley Works
New Britain, Connecticut

Board public-policy committees and parallel management committees have played a significant role in this process. Ronald F. Gilrain described the evolution at his company, a change in which the altered committee structures reflected the overall shifts in corporate governance.

> "Community service is not new to the Stanley Works. We've been involved in community affairs for 141 years, and each time we planted our foot in a new location we have continued that same feeling of responsibility and good corporate citizenship. In earlier times, it was easier to be a good corporate citizen because the officers and board members were mostly residents of New Britain, Connecticut, our company's headquarters. They understood the community's needs and acted to meet these needs as private citizens and as company officers. Twenty years ago, fourteen of our fifteen corporate directors were Connecticut

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[3] In 1982, company foundations participating in The Conference Board's Annual Survey paid out $532 million, but received only $367 million from their parent companies. Troy, 1984.

> residents and ten were from New Britain. We had a hometown board of directors in an international business. Today, of fourteen directors, seven are from Connecticut and only one—our CEO and Chairman—is from New Britain.
>
> "We recognized that we needed a more formal process for contributions and services. There was a separate evolution of both our board and management committees. In 1970, we had a corporate contributions committee of the Board. In 1980, this became a board public-policy committee whose members were our chairman and four outside directors. Its scope was expanded to include: contributions, community relations, environmental quality, EEO, occupational safety and health, employee rights, consumer relations, and government relations. I serve as the management liaison to the Public Policy Committee, and work with the Chairman (one of the outside directors) to develop the agenda, prepare position papers and action plans, and make a presentation to the full board every 12 to 18 months.
>
> "The management committee parallels the board committee. In 1970, a Public Affairs Advisory Panel (now called Council) was set up. It was democratized, and now has a membership of 20 employees drawn from all levels from clerks to professionals selected because of their interest in community affairs.
>
> "The Board's Public Policy Committee has suggested plans and the Public Affairs Advisory Council (which now also has local councils) has implemented them. The board committee set goals for giving, and the management committee drew the plan that increased giving from 0.48 percent of worldwide pretax income in 1979 to 0.96 percent worldwide in 1983. We plan to go to 1 percent of worldwide pretax income in 1985, and to 1½ percent in 1987."

In moving down the road to institutionalization, each company passes familiar signposts (planning, program focus, etc.), but the time-tables are different and singularities of approach are evident. Top-management interest has been formalized in committee structures, but its involvement may also have been diluted.

Two of the panelists provided corporate chapter and verse on the institutionalization process in their firms. James C. Schwaninger described the course at J.C. Penney:

> "If we look way back at the history of corporate involvement in society's affairs, we see that the chief executive officer, who was often the sole owner or senior member of the family that owned the business, made all charitable decisions. It was part of the style of management that didn't have room for committee or staff decisions. The boss was the boss was the boss.
>
> "Then, companies became bigger, publicly owned, more geographically diverse, and infinitely more complex. So the function was delegated—to the treasurer or secretary, personnel director, advertising manager, or public-relations officer. CEO's were active only if the request jibed with their personal interests or came directly from another CEO. In time, committees were formed to pass judgment on contributions requests. Day-to-day management was delegated to a staff person. That is pretty much where we are today.
>
> "This process may—or may not—mean that the function has been pushed down in the corporate structure. Corporate power can be measured in three dimensions: money controlled, people involved, and closeness to the highest level of management."

JAMES C. SCHWANINGER
Manager of Corporate Responsibility
and Community Relations
J.C. Penney Company
New York, New York

Other panelists pointed out that varying perceptions of the importance of the contributions function can lead to different methods of staffing. Who are the people currently in the contributions function, what is their future career path? Mr. Schwaninger responded:

> "One—male senior managers who are probably in their last assignment before retirement. Sometimes the company is giving them a chance to 'deflate' a bit.
>
> "Two—a former nonmanagement person being rewarded for years of dedicated service. This person, who is almost always female, is moved into a job that may have been institutionalized by a male manager who has been given another assignment. She may be smart as a whip, but she may have never managed a function like this before.
>
> "Three—the outsider, from the education, government or another nonprofit field. The outsider was brought *inside* because of a special knowledge of the philosophies and practices of philanthropy. If the outsider is going to interface with established insiders, he or she has to make learning the business the first priority.
>
> "Four—the fast trackers—men and women on the way up. They may have been moved diagonally into the function as a chance to broaden their experience and prepare them for greater things. They will make their mark in contributions, then be promoted to a higher position in that department or moved to another area of the company.
>
> "In the future, I don't think gender will make a difference—the *person* will. The future of the corporate contributions function lies with the *abilities* of the people who fill it. The function can be fully formalized as a normal, historical, important part of the corporation only if the people who do the job find the ways to make it so."

A significant corporate reorganization can have a major impact on staffing. The break-up of the Bell System has been reflected in the realignment of the contributions function, and in the formation of the $100-million AT&T foundation. Edward M. Block said:

> "Corporations, like people, need a trauma to get moving. When we broke up the Bell System, that necessitated rethinking our approach to corporate contributions along with everything else. Total Bell-System contributions were

$60 million, and the lion's share was given by the Bell companies to meet local and regional needs. AT&T and the other national units of the system focused on national causes. The local telephone company was the 'Steady Eddie' friend of the community.

"Why did we set up a foundation? First, to reduce expenses. Second, to take full advantage of the tax code. Third, to insure a steady source of funding in the lean years. Fourth, to upgrade the management of philanthropy. It required more than just a change in style. It required a change in substance. So we looked outside of our business for a professional with the credentials and experience to run such a foundation.

"You can't turn the QE-2 around in a bathtub. And we can't turn our philanthropy around immediately. In time, the change will be profound. AT&T's focus is global now, not solely domestic. We are no longer a public utility. We are selling applications of electronic technology; our objective is rapid innovation, our environment is very risky. What will we do differently in philanthropy? We intend to get greater recognition for what the corporation does. We are going to be more selective in grants, take more risks, seek a higher profile. We are going to attune our philanthropy to the corporation's business objectives, tied much more tightly to our communications and marketing strategies.

EDWARD M. BLOCK
Senior Vice President, Public Relations
American Telephone and Telegraph
Company
New York, New York

"Time, competency and a whole bunch of luck will determine whether we are able to do anything with this magnificent foundation. Professional management is essential to institutional accountability. There should be purposeful direction for 85 percent of our giving. Once you get past the $5-million mark, you better stop running your contributions out of your hip pocket and get serious about managing it."

The Corporation in the Community

Another element in the new pattern of corporate giving is the focus on the community. But which community, one may ask? Certainly, the panelists say, the communities in which companies have plant and branch locations—as well as the communities in which their employees live. And often this extends to large urban communities in which the company may have a presence, and in which the problems are of major scope and in urgent need of attention. There is some shifting of the spotlight from the relative serenity of headquarters to the sprawling community scene. This is partly because headquarters programs have attained a level of sophistication, partly because changing government-funding patterns call for more community action, partly because local needs demand corporate attention.

SAMUEL M. CONVISSOR
Staff Vice President,
Corporate Relations
RCA Corporation
Princeton, New Jersey

Samuel Convissor has spent more than two decades in such work, and outlined the concerns:

> "What were once relatively easy and often insignificant responsibilities, the community-relations and corporate-philanthropic functions, are now important pieces of the company's public-affairs or employee-relations activity. In some instances, with the exception of press relations (news releases regarding products and business or financial news), the community-relations and contributions programs represent the total external-relations activity of the company.
>
> "Why is all this new today? First, there is more public-policy and citizen-directed activity influencing the decisions of the private sector. Whether it is environmental problems, plant-closing legislation, growing costs of unemployment-compensation claims, right-to-know legislation, zoning problems, traffic, or other quality-of-life issues, the community-relations function can serve as an early-warning system of corporate problems ahead and, certainly, as an antenna to pick up important community issues.
>
> "We see some clear signs of the importance of this new corporate work. The spate of publications, articles, speeches, conferences; the formation of new foundations—all are evidence of the new focus. Finally, there is the recognition of the problem-solving role of this sector in the important areas of health care, housing, economic development, education, and other community improvement issues. People working in this field are generalists and they understand the seamless web that ties and holds communities together."

Assessing Community Needs

Community-needs assessment has become an important tool for the corporation desiring to target its aid activities and to have an impact on defined key areas. How it is done and how areas of major opportunity are identified and addressed was a concern of the panelists. Chad J. Bardone set out one model that Sun Exploration and Production

CHAD J. BARDONE
Vice President, Public Affairs
Sun Exploration and Production
Company
Dallas, Texas

Company used in Dallas when it moved from a decentralized to a centralized operation.

> "The 1980 census data showed a drastic departure from 1970. The black population was growing three times as fast as the population as a whole; the Hispanic population was growing nine times faster than the community as a whole. The projections showed the affluent were going to get better and better off, the low income groups would get worse and worse off.
>
> "We did not see enough of a relationship between what we were doing in contributions and public affairs and what was happening in the community. At the recommendation of the corporate office, we hired a consultant—Human Resources Network of Philadelphia—in the Fall of 1982, to do a three-month needs assessment of the key problems of the community, as seen through the eyes of the community. We wanted an unbiased assessment. We wanted the consultant to pick out areas of community need where we could truly make a difference.
>
> "The results gave our company a better handle on structuring our community-relations program. The 58-page report covered 21 major areas, and was broken into two parts—background information and opportunities for corporate partnership with about three options per area. We got a smorgasbord of about 60 new ideas.
>
> "Two critical needs emerged: developing minority leadership in Dallas, and assisting the independent school district. We now look at charitable contributions requests in light of the community-needs assessment. A couple of quick examples. There is a new group on Hispanic leadership development to which we gave a grant and put an executive on the board. A similar thing has happened with a black group. We would not have done this kind of thing two years ago because the risk would have seemed too great. This process has taken us from a traditional program to addressing more critical needs. It allows us to feel right about taking some of these risks."

Public Pre-College Education

Public secondary and elementary education is this year's hot issue. The panelists report that this is not a new need, but a new focus of attention. Ten major public reports on the problems of kindergarten through twelfth-grade public education were issued in the last year. One bank's program and one city and state's problems were vividly described by Tim Kilduff of Boston's Bank of New England.

> "We at the Bank of New England needed to assess business perceptions of public education. Basically, they fell into three areas: First, business judges the current product emerging from the schools to be inadequate. This involves the issue of standards and testing. Second, the future will demand higher skills for entry-level jobs, and that translates into the issue of curriculum. Third, public education has to do a better job in developing allies. Public-education lobbies are extremely complicated, and business finds that education groups spend most of their time talking to themselves. We must build coalitions.

TIMOTHY W. KILDUFF
Vice President, Public Affairs
Bank of New England
Boston, Massachusetts

> "Here are some of the things business is looking for.
>
> - Efficiency in the form of less rigid tenure rules.
> - More freedom to discipline or dismiss ineffective teachers, principals and other administrators.
> - A system that requires teachers to upgrade their skills is absolutely critical. There are some contributions opportunities in that area, too.
> - Teacher testing and student testing. When you get into teacher licensing, it is a political quagmire.
> - Curriculum reforms—I think we all agree on this need.
>
> I think we have to come out for incentive pay for teachers who are willing to upgrade their skills (not all of them are), and for teachers to teach teachers."

The Bank of New England participated in the political arena through involvement in a six-month study sponsored by the Massachusetts State Legislature in cooperation with the Governor. During this study, the bank arranged for CEO testimony at public education hearings. The Bank also worked with the Massachusetts Business Roundtable Task Force on Education to assure a broad public debate. Mr. Kilduff developed a comprehensive resource file and an extensive bibliography that were circulated through the legislature. The Bank also funded an objective analysis of educational problems that sets forth the pros and cons on the important issues.[4]

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[4] *Issues in Education: An Examination,* developed by the School of Education, University of Massachusetts, 1984.

Mr. Kilduff says of the future:

> "Colleges and universities are going to be all over, proposing to do training programs for teachers and have the business community pay for it. Economic-development groups will be pushing programs in adult literacy, and will expect business to fund them. We have to be more honest with each other and share more information. It is a frustrating area to be involved in. Before you jump in with both feet, do that homework, assess the environment in which this issue is being debated, understand the players, and determine for yourself what your objectives are going to be and how you are going to play in the game."

Use of Multiple Corporate Resources

Addressing community needs requires the application of multiple corporate resources in order to extend effectively the corporation's social reach. Again, the panelists concluded that an overall plan is essential, but noted this does not preclude incremental approaches on a case-by-case basis. The Metropolitan Life Insurance Company has identified nine corporate resources. Anne Impellizzeri described this involvement:

> "We have used four *economic* resources: insurance products and services, investments, hiring practices, and purchasing. We have also used four *public-service* resources: time and talent of company people (from the CEO through management and technical assistance to employee volunteers); in-kind services (such as printing, computer time, and meeting space); support for public policy (such as the Job Training Partnership Act); and, of course, financial contributions. A ninth resource, which can amplify all the others, is communications including the press and electronic media, publications, employee communications, and advertising.
>
> "We have applied multiple resources in our work with the New York City Partnership in the Summer Jobs program. Nationally and in communities across the country we have worked with chambers of commerce, private industry councils (PIC's) opportunities industrialization centers (OIC's) the Urban League, SER-Jobs for Progress, and many others.
>
> "What have we learned? First, the direction of the future is more focus: externally on selected public interest priorities, internally on company business objectives.
>
> "Second, we serve the public best when we also serve the company.
>
> "Third, there is strength in genuine partnerships where all parties have a stake in the outcome.
>
> "Fourth, we can often achieve much by working with our peers in other functions in the company.
>
> "And, fifth, while it is desirable to have a comprehensive policy and plan, we can often do much on a case-by-case incremental basis."

ANNE E. IMPELLIZZERI
Vice President, Corporate
Social Responsibility
Metropolitan Life Insurance Company
New York, New York

Communicating the Corporate Program

As already noted, there was a time when corporate contributions never saw the light of day. Such life in the darkness was standard practice until the urban riots of the late 1960's gripped the country's attention. A few of the more adventurous corporations broke the silence and decided to tell the world what they were doing. Looking back, the panelists recall there were no shattering consequences to such disclosures, no massive protests, no overwhelming commendations. What happened was simply a gradual disclosure, a gradual acceptance, and increased communication and dialogue with all concerned audiences.

RICHARD F. NEBLETT
Manager-Contributions Coordination
Exxon Corporation
New York, New York

Richard Neblett, summed up the new stance by quoting Exxon's Chairman C.C. Garvin, Jr.:

> "Businessmen should focus on philanthropic activities just as we focus on regular business activities when we are really determined to get things done. We have a splendid—perhaps a unique—opportunity in the next few years to demonstrate anew that the economic system we believe in can work, and work well, in the public interest."
>
> Said Neblett: "The key thought in that paragraph is *the public interest*. It then follows that if contributions activities are in the public interest, why should they be kept secret? This is a logical inconsistency. Not only should corporations conduct contributions programs—and this belief is certainly the current consensus of business leadership—but they should communicate about them."

Planning A Communications Program

Panelists believe that more attention must be paid to planning a comprehensive communications program. But, what should it say? To whom should it be addressed? How should that communication be made? What will it cost?

CLIVE J. WRIGHT
Senior Advisor, Public Affairs
Department
Exxon Corporation
New York, New York

How can we measure its effectiveness? Some panelists had difficulty assessing these questions, and Clive Wright admitted that "contributions 'goals' are not so easy to spell out and measure." But concerted effort should be made and "individual judgments should be buttressed by hard data wherever possible"—opinion research, continuous omnibus surveys, focus groups, and specific program evaluations. For example, the focus groups conducted for Exxon last year revealed that "socially and politically active people were keenly interested in what we were doing—*but at the local level*. That was very valuable to us and we are acting on that research." Wright described the process that Exxon uses to frame its communications program. (See box.)

Exxon's Communications Program

Exxon has a three-tier model for its corporate-responsibility program, and the communications needs for each tier are different. The first tier covers those activities that a company takes in direct pursuit of its business. In Exxon's case, this means providing energy as efficiently as possible and making sure our products meet the right standards of quality. The communications are straightforward and directly promote business goals.

The second tier relates to the activities that derive directly from the pursuit of our business—for example, protection of the environment, hiring of minorities, and so on. In this tier, communications are in support of business goals and would generally take the form of demonstrating that society can be confident that these business goals are not being pursued at the expense of society's legitimate concerns.

The third tier consists of those activities that are undertaken voluntarily in line with how Exxon perceives its community and cultural responsibilities toward the preservation of a viable society in which to live, work and do business.

Source: Excerpted from remarks by Clive J. Wright at The Conference Board's 1984 Workshop on "The Future of Corporate Contributions."

> He noted that: "At Exxon, we contribute some $53 million a year, more than half of which goes to education; but we also support the arts, public broadcasting, and a wide number of civic and community causes. Each contributions program will have an identified goal. From that point of departure, we can make an analysis of our communications plan."

Accurate identification of the target is always important:

> "Exxon is concerned primarily with specialist audiences rather than general public interest. Employees are a vital target audience, a very valuable and much underestimated communications vehicle. Other specialist audiences we are going to be thinking about in our communications plans are recipients of contributions—beneficiaries such as arts audiences or students—special interest groups such as environmentalists or local residents. Through a 'trickle-down' effect, these audiences act as communicators about what we are doing."

> Wright concluded on two notes of caution. "First, avoid the appearance of being self-serving. Second: Don't place too high a premium on receiving measurable results on achieving desired general goals. There is a lot of clutter in the world that makes it difficult to isolate our communications from other influences."

Robert Schneider pioneered communications at Xerox. "Not too many years ago we were all underground, and the contributions function begged for organization. The change took place abruptly in the mid-to-late 1960's—the post-riot period. Now, there is a high degree of visibility and acceptance by the public. In this completely open environment, with whom should we communicate?" Schneider's list of the audiences that Xerox wants to reach in its communications program appears in the box on page 11.

Another question is: "What vehicles do we use?" Schneider mentioned several:

> "The 'Great Big Glossy'—the Social Responsibility Report. This is an all-embracing vehicle, and we've done several. The dullest part is a long internal contributions listing, and I question whether it has a place in this kind of report. I try to make them project-oriented; to breathe life into them; to personalize them to the greatest extent possible.
>
> "Our senior managers comment on social and philanthropic activity in their speeches. It is important to engage management in communicating this aspect of corporate life.

ROBERT M. SCHNEIDER
Vice President, Public Affairs
Xerox Corporation
Stamford, Connecticut

Xerox's Target Audiences

(1) The nonprofit world: We must tell them what we are about, what our goals and objectives are. "This is what we want. Here are proposals we will—or will not—entertain." We need to lay out clearly the format in which we want to receive proposals. We should explain the decision-making process of the corporation.

(2) The shareholders: Some companies tend to overestimate their interest. We have had no more than half a dozen critical comments over the years, and half of those were from "annual meeting gadflies." Most shareholders are highly favorably disposed to corporate contributions. We use three vehicles—the annual report, the quarterly report, and the post-annual meeting report.

(3) Top management: We must keep them aware of the philanthropic program, usually through meetings. We report to the board of directors once a year, and they show great interest, particularly outside directors.

(4) The employees: We are a communications company, never satisfied with what we do. We flood the employees with information, and perhaps at times give them much more than is really necessary. But we do want to improve employee pride in the corporation. Employees who are aware of the good works the corporation is doing, particularly in the community, and nationally as well, become a corps of goodwill ambassadors. We have run into trouble in only one instance during a period of manpower reduction. Then we received letters from employees asking: "How can you give money away when you are laying off part of the work force?" This is very difficult to answer, but we always have institutional responsibilities and we are going to meet them in good times and bad. The philanthropic program is one such responsibility.

(5) Special interest groups that have a particular interest in the contributions program.

Source: Excerpted from remarks by Robert M. Schneider at The Conference Board's 1984 Workshop on "The Future of Corporate Contributions."

"Customers are critically important. We reach them through our salesmen and service people. Our market research reveals that when products and pricing are about the same, secondary considerations become part of the buying decision. The character of the corporation then comes into play.

"Communication is a vitally important part of the philanthropic effort. Unless it is done with care, with a plan, with specific objectives, and with a certain sense of humility, it will be viewed as pure promotion."

Panelist Gerald Horton addressed another facet of the communications problem, stating: "There is a political cast to what we do that began to develop in the late 1960's. We need the public trust to be allowed to do our business. There is some kind of contract out there between the private corporation and the world at large."

Horton challenged the profession, declaring: "If you don't want to talk about a program, don't do it. But when you do it, be honest—do it in a forthright manner."

GERALD T. HORTON
Chairman
Ogilvy and Mather
Public Relations Group
New York, New York

"In the 1960's, a constituency developed for corporate social action. The whole philosophical premise of business was being redefined by a group of activists who heretofore had not been an influence on business.

"The old definition said make a good product, sell it at a fair price, and return an adequate amount to your shareholders. Then new voices began to be heard. One said: 'While not polluting the environment.' Another one said: 'While hiring blacks.' The next said: 'While hiring Asians.' And handicapped folks. While doing it in a safe place. While not doing it in my backyard. While doing it with some sense of responsibility to the elderly. And that agenda continued to grow.

"What business wanted was the public's trust, and we truly need to get something out of these programs. Be very clear that you are self-serving; accept that fact.

"If it is a political battle, and I suggest it is, remember that nobody in a political race ever did anything without telling anybody. We must communicate better, both to the outside world and our own people. You're not the conscience of the company—you're the front-line foot soldier."

The Outlook

In summation, new patterns are developing in corporate contributions. The profiles vary from company to company, but the basic outlines are now in place. "Leading edge" corporations have planned and staffed sophisticated programs are reaching out to "their" communities across the land (and sometimes overseas), are more willing to tackle the tough issues, and to talk out loud about their firms' successes—and the also-rans as well. Such programs may become models to be emulated and adapted by other companies—large and small—that have less focused contributions activities.

As the contributions function becomes more institutionalized, more firmly embedded in the corporate structure, there will be less need to keep shouting: "We're here, we're here." But institutionalization and formalized structure also have their side effects. The movement from a CEO staff location to a more routine program can mean diluted power and influence as well as lower-level staffing. Gender implications also trail in the wake of these evolutions, and in all but the largest companies the function is increasingly female.

Opportunities abound. As Waldemar Nielsen observed: "We are coming alive intellectually" and can address large and complex problems. Again, the leading corporations are aggressively attempting to do so; but many companies are mired in routine "tried and true" elements of a contributions program. In contributions, as in other functions, change means risk—and chance of failure, sometimes a forfeited job.

Corporate cost cutting and cost control will prevail in the 1980's, in good times and bad. This means for the foreseeable future, leaner staffs and fatter workloads for contributions managers.

The panelists observe that corporate contributions has "come a long way"—but there is still a long journey ahead. Its organizational position has become stronger and program results are more identifiable (if not precisely measurable). Heightened presence in the community will enhance the role of contributions activities.

The state of the economy will continue to be the dominant factor in corporate giving, and budget adjustments are likely to track those made for other non-profit-making functions in the company. The corporate contributions function will have to prove itself, will have to show it is getting a significant return for the firm's investment. As it does so, the function will increasingly become part of corporate America.

Early Findings from The Conference Board's Annual Survey of Corporate Contributions

by Linda Cardillo Platzer

The tables that follow[1] are derived from information obtained from The Conference Board's latest contributions survey, in which 503 companies reported on their 1983 contributions activities. This study is an ongoing part of The Conference Board's examination of corporate contributions practices and is conducted on an annual basis.

Data from the Internal Revenue Service and the Council for Financial Aid to Education for 1980-82 indicated significant increases in corporate contributions budgets. As previously noted, this occurred in the face of declining corporate profits as announced by the U.S. Department of Commerce in the same time period. However, in 1983, while U.S. corporations reported a nearly 23 percent increase in profits over 1982, the charitable contributions of those corporations advanced at a rate of slightly over 7 percent (See Table 1).

The 503 companies participating in The Board's survey contributed a total of $1.4 billion, or 46%, of the estimated $3 billion given by all U.S. corporations. Corporate foundations continued—for the fourth year in a row—to make contributions well in excess of the grants they received from their corporations. But in 1983—although still large—the gap between money paid out by those foundations and that taken in began to close. In 1982, corporate foundations gave 45 percent more than they received, while in 1983, they gave 27 percent more.

Although total contributions grew only modestly during 1983, corporations do appear to be making significant changes in how they distribute their contributions dollars among the five major categories of recipients. For example, contributions to civic and community activities jumped to 14.8 percent of the total—after having stabilized for three straight years at 11.7 percent. The proportion given to health and human service beneficiaries has declined from 34 percent in 1980 to 28.7 percent in 1983 and giving to education, as a percent of the total, declined slightly to 39 percent from its four-year high of 40.7 percent in 1982. Contributions to culture and arts remained steady at 11.4 percent of the total, and donations to "other" beneficiaries increased moderately, now representing 6.1 percent of all contributions.

An important factor first noted in last year's survey is again seen in the 1983 survey data. Noncash contributions—mainly gifts of company products and other property such as equipment, land and buildings—continue to play an important role in corporate charitable giving, now accounting for 11 percent of the total reported by participating companies.

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[1] Except for Table 1, Corporate Contributions and Corporate Income Before and After Taxes.

Table 1: Corporate Contributions and Corporate Income Before and After Taxes[1]

Year	Contributions				
	Amount ($ Millions)	Income[3] before Taxes ($ Millions)	As Percent of Income before Taxes	Income[3] after Taxes ($ Millions)	As Percent of Income after Taxes
1936	$ 30	$ 7,900	0.38%	$ 4,900	0.61%
1937	33	7,900	0.42	5,300	0.62
1938	27	4,100	0.65	2,900	0.93
1939	31	7,200	0.43	5,700	0.54
1940	38	10,000	0.38	7,200	0.53
1941	58	17,900	0.32	10,300	0.56
1942	98	21,700	0.45	10,300	0.95
1943	159	25,300	0.63	11,200	1.42
1944	234	24,200	0.97	11,300	2.07
1945	266	19,800	1.34	9,100	2.92
1946	214	24,800	0.86	15,700	1.36
1947	241	31,800	0.76	20,500	1.18
1948	239	35,600	0.67	23,200	1.03
1949	223	29,200	0.76	19,000	1.17
1950	252	42,900	0.59	25,000	1.01
1951	343	44,500	0.77	21,900	1.57
1952	399	39,600	1.01	20,200	1.98
1953	495	41,200	1.20	20,900	2.37
1954	314	38,700	0.81	21,100	1.49
1955	415	49,200	0.84	27,200	1.53
1956	418	49,600	0.84	27,600	1.51
1957	419	48,100	0.87	26,700	1.57
1958	395	41,900	0.94	22,900	1.72
1959	482	52,600	0.92	28,900	1.67
1960	482	49,800	0.97	27,100	1.78
1961	512	49,700	1.03	26,900	1.90
1962	595	55,000	1.08	31,100	1.91
1963	657	59,600	1.10	33,400	1.97
1964	729	66,500	1.10	38,500	1.89
1965	785	77,200	1.02	46,300	1.70
1966	805	83,000	0.97	49,400	1.63
1967	830	79,700	1.04	47,200	1.76
1968	1,005	88,500	1.13	49,400	2.03
1969	1,055	86,700	1.22	47,200	2.24
1970	797	75,400	1.06	41,300	1.93
1971	865	86,600	1.00	49,000	1.76
1972	1,009	100,600	1.00	58,900	1.71
1973	1,174	125,600	0.93	76,600	1.53
1974	1,200	136,700	0.88	85,100	1.41
1975	1,202	132,100	0.91	81,500	1.47
1976	1,487	166,300	0.89	102,500	1.45
1977	1,791	194,700	0.92	122,000	1.47
1978	2,084	229,100	0.91	145,900	1.43
1979	2,288	252,700	0.91	165,100	1.39
1980	2,359	234,600	1.01	149,800	1.57
1981	2,514	221,200	1.14	140,000	1.80
1982	2,800(est.)[2]	165,500	1.69	104,800	2.67
1983	$3,000(est.)[2]	$203,200	1.48	$127,400	2.35

[1] Reflects total consolidated corporate income before and after taxes.

[2] From Council for Financial Aid to Education.

[3] The net income figures on this table have been adjusted to coincide with recently updated data issued by the Department of Commerce. Thus, some of the figures in the income columns, and the ratios based upon them, will differ slightly from those published here previously.

Note: Figures in this table reflect contributions and income of *all* U.S. corporations. Figures in all other tables in this report are based solely on responses by survey participants.

Sources: Department of Commerce, Internal Revenue Service.

Table 2: Distribution of Corporate Contributions
(millions of dollars)

	1983 471 companies		1982 534 companies		1981 788 companies	
Health and Human Services	$ 367.6	28.7%	$ 397.3	31.0%	$ 393.4	33.6%
Education	498.8	39.0	522.2	40.7	429.8	36.7
Culture and Art	145.2	11.4	145.8	11.4	139.6	11.9
Civic and Community Activities	188.8	14.8	149.3	11.7	136.7	11.7
Other	78.0	6.1	67.0	5.2	71.3	6.1
Total	$1,278.4	100.0%	$1,281.6	100.0%	$1,170.8	100.0%

Table 3: Structure of Corporate Contributions
(millions of dollars)

	1983	1982	1981
Total company contributions	$1,250.7 (484)	$1,116.8 (519)	$1,039.1 (768)
Less: Grants to company foundations	435.7 (159)	367.1 (186)	361.6 (239)
Other company contributions	815.0 (461)	749.7 (494)	677.5 (735)
Plus: Contributions by company foundations	553.0 (270)	531.9 (286)	493.3 (359)
Total corporate contributions	1,368.0 (503)	1,281.6 (534)	1,170.8 (789)

(Numbers in parentheses are counts of non-zero answers.)

Table 4: Relationship of Foundation Payouts to Pay-ins
(millions of dollars)

	1983		1982		1981	
	Amount	Number of Companies	Amount	Number of Companies	Amount	Number of Companies
Grants to company foundations	$435.7	159	$367.1	186	$361.6	239
Contributions by company foundations	553.0	270	531.9	286	493.3	359
Payouts less pay-ins	117.3	111	164.8	100	131.7	120
Percent payouts exceeded pay-ins	26.92%	69.81%	44.89%	53.76%	36.42%	50.21%

Table 5: Summary of Charitable Contributions Expenditures
(millions of dollars)

	Company Foundation		Direct Giving Program		Total	
Description	Sum	Percent	Sum	Percent	Sum	Percent
Cash	$509.14 (239)	99.87	$599.95 (402)	81.19	$1,109.09 (446)	88.82
Securities	0.05 (1)	0.01	4.60 (12)	0.62	4.64 (13)	0.37
Company Product	0.00 (0)	0.00	74.61 (79)	10.10	74.61 (79)	5.97
Property other than product	0.63 (2)	0.12	59.76 (83)	8.09	60.39 (85)	4.84
Total	509.82 (239)	100.00	738.92 (406)	100.00	1,248.73 (447)	100.00

(Numbers in parentheses are counts of non-zero answers.)

Table 6: Corporate Contributions, Two Survey Years
304 Companies Reporting Worldwide Pretax Net Income in Both Years

	1983 (000)	*As a % of PTNI*	*As a % of Total Contributions*	*1982 (000)*	*As a % of PTNI*	*As a % of Total Contributions*	*% Change 1982-83*
Total Worldwide PTNI	$133,303,866[1]			$116,498,559			14.43
Total Contributions	$1,090,517	0.82	100.00	$968,768	0.83	100.00	12.57
Health and Human Services	310,664	0.23	28.49	279,718	0.24	28.87	11.06
Education	431,653	0.32	39.58	409,739	0.35	42.30	5.35
Culture and Art	124,662	0.09	11.43	113,482	0.10	11.71	9.85
Civic and Community	160,543	0.12	14.72	112,965	0.10	11.66	42.12
Other	62,995	0.05	5.78	52,864	0.05	5.46	19.16

[1] Companies reporting an income loss in either year have been excluded.

Table 7: Total Contributions and Educational Support in Relation to "Worldwide" Pretax Net Income and Assets

	1983 471 companies (000 omitted)	*1982 513 companies (000 omitted)*	*1981 712 companies (000 omitted)*	*1980 659 companies (000 omitted)*	*1979 730 companies (000 omitted)*
Total Contributions	$ 1,329,633	$ 1,255,464	$ 1,116,261	$ 959,249	$ 805,521
Support of Education	518,713	511,725	407,270	362,494	303,876
Pretax Net Income	152,832,000	134,746,000	165,277,000	164,735,000	159,841,000
Total Assets	2,852,949,000	2,921,421,000	2,959,364,000	2,642,819,000	2,352,594,000
Total Contributions as a Percentage of:					
Pretax Net Income	0.870	0.932	0.675	0.582	0.503
Total Assets	0.047	0.043	0.038	0.036	0.034
Support of Education as a Percentage of:					
Pretax Net Income	0.339	0.380	0.246	0.220	0.190
Total Assets	0.018	0.018	0.014	0.014	0.013
Support of Education as a Percentage of:					
Total Contributions	39.0	40.8	36.4	37.8	37.7

Table 8: Total Contributions and Educational Support in Relation to "U.S. Only" Pretax Net Income and Assets

	1983 368 companies (000 omitted)	*1982 383 companies (000 omitted)*	*1981 525 companies (000 omitted)*	*1980 477 companies (000 omitted)*	*1979 543 companies (000 omitted)*
Total Contributions	$ 1,011,374	$ 918,595	$ 681,494	$ 532,260	$ 498,063
Support of Education	405,969	358,383	235,115	192,482	188,832
Pretax Net Income	89,035,000	79,334,000	81,833,000	65,963,000	74,711,000
Total Assets	1,600,112,000	1,637,241,000	1,552,140,000	1,190,370,000	1,218,375,000
Total Contributions as a Percentage of:					
Pretax Net Income	1.136	1.158	0.833	0.807	0.667
Total Assets	0.063	0.056	0.044	0.045	0.041
Support of Education as a Percentage of:					
Pretax Net Income	0.456	0.452	0.287	0.292	0.253
Total Assets	0.025	0.022	0.015	0.016	0.015
Support of Education as a Percentage of:					
Total Contributions	40.1	39.0	34.5	36.2	37.9

Table 9: Summary of Corporate Assistance Expenditures[1]

Description	Number of Companies Reporting	Sum ($ Thousands)	Median
Cash Disbursements to 501(C) (3) Organizations Not Reported as Charitable Contributions	134	$ 67,161	$ 59,485
Loan of Company Personnel	63	23,603	70,000
Donations of Product and Property Not Reported as Charitable Contributions	72	36,523	27,008
Use of Corporate Facilities or Services	60	6,409	8,005
Loans at Below Market Yields	17	3,958	21,000
Administrative Cost for Contributions Function	130	30,293	69,011
Total	208	167,947	102,002

[1] Corporate Assistance expenditures go to charitable and other groups in order to promote social well being. These expenditures are not taken by companies as a charitable deduction. The data were collected for the first time in 1982. (See Table 12, footnote 1.)

Table 10A: Contributions as a Percent of U.S. Pretax Net Income, 1983

Companies Grouped by Industry Class[1]

Industrial Classification	Number of Companies	U.S. Pretax Net Income (Sum) ($ Millions)	Contributions (Sum) ($ Thousands)	U.S. Pretax Net Income (Median) ($ Thousands)	Contributions (Median) ($ Thousands)	Percent of Contributions to U.S. Pretax Net Income (Median)
Chemicals	25	$ 6,892	$ 148,450	$102,500	$1,907	1.65%
Electrical machinery and equipment	28	12,120	161,001	102,332	1,180	1.19
Fabricated metal products	10	1,796	5,329	37,639	259	1.09
Food, beverage and tobacco	25	7,443	84,696	172,309	1,642	0.94
Machinery, nonelectrical	11	736	9,109	79,961	857	1.25
Mining	1	31	237	*	*	*
Paper and like products	12	874	18,936	56,816	734	1.01
Petroleum and gas	15	16,331	222,107	841,000	1,230	1.50
Pharmaceuticals	9	2,354	30,348	214,600	1,780	1.21
Primary metal industries	6	376	12,410	*	*	*
Printing and publishing	7	1,321	13,119	*	*	*
Rubber and miscellaneous plastic products	6	800	5,888	*	*	*
Stone, clay and glass products	7	687	7,127	*	*	*
Textiles	9	678	9,878	28,422	345	1.81
Transportation equipment	9	9,197	82,168	475,000	6,361	1.05
Total: Manufacturing	180	61,636	810,803	95,268	1,042	1.24
Banking	45	2,819	44,600	23,226	399	1.61
Business services	6	829	7,516	*	*	*
Engineering and construction	2	75	1,092	*	*	*
Finance	4	489	10,460	*	*	*
Insurance[2]	41	2,295	51,887	40,594	505	1.77
Retail and wholesale trade	12	3,106	44,510	56,383	822	1.30
Telecommunications	19	11,671	86,914	457,000	2,342	0.50
Transportation	7	1,914	12,720	*	*	*
Utilities	52	15,021	41,868	151,442	572	0.29
Total: Nonmanufacturing	188	38,219	301,567	64,174	607	0.99
Total: All Companies	368	99,855	1,112,370	79,831	796	1.12

[1] Loss companies excluded.

[2] Insurance company figures are based on "net gain from operations after dividends to policyholders and before federal income tax, excluding capital gains and losses"—the closest measure to pretax net income of corporations generally.

*Industries with less than 8 cases are excluded.

Table 10B: Contributions as a Percent of Worldwide Pretax Net Income, 1983
Companies Grouped by Industry Class[1]

Industrial Classification	Number of Companies	Worldwide Pretax Net Income (Sum) ($ Millions)	Contributions (Sum) ($ Thousands)	Worldwide Pretax Net Income (Median) ($ Thousands)	Contributions (Median) ($ Thousands)	Percent of Contributions to Worldwide Pretax Net Income (Median)
Chemicals	29	$ 12,235	$ 157,765	$ 166,638	$2,065	1.25%
Electrical machinery and equipment	34	18,790	176,381	108,641	1,180	1.02
Fabricated metal products	10	1,887	5,329	54,690	259	0.90
Food, beverage and tobacco	28	10,681	94,694	266,153	1,990	0.88
Machinery, nonelectrical	15	1,022	11,103	58,782	736	1.25
Mining	1	48	237	*	*	*
Paper and like products	16	1,336	22,137	72,573	793	0.90
Petroleum and gas	20	40,305	257,509	1,491,742	8,670	0.55
Pharmaceuticals	16	4,913	56,928	167,728	1,309	0.96
Primary metal industries	7	429	12,598	*	*	*
Printing and publishing	11	1,894	20,839	200,768	1,287	0.96
Rubber and miscellaneous plastic products	8	1,140	7,702	93,377	694	0.67
Stone, clay and glass products	9	921	13,324	71,873	668	0.97
Textiles	11	889	11,438	50,193	373	1.38
Transportation equipment	13	12,100	88,441	461,800	2,900	0.69
Total: Manufacturing	228	108,590	936,425	118,092	1,068	0.96
Banking	53	7,224	71,680	29,288	530	1.42
Business services	9	1,344	9,339	165,400	800	0.77
Engineering and construction	2	99	1,092	*	*	*
Finance	6	1,414	17,426	*	*	*
Insurance[2]	46	3,189	61,991	41,499	532	1.74
Retail and wholesale trade	16	4,201	56,187	83,181	839	1.01
Telecommunications	19	12,202	86,915	541,800	2,342	0.50
Transportation	9	1,998	13,069	59,554	563	0.79
Utilities	56	16,687	48,186	183,711	611	0.30
Total: Nonmanufacturing	216	48,358	365,885	82,720	702	0.92
Total: All Companies	444	156,948	1,302,310	98,182	869	0.94

[1] Loss companies excluded.

[2] Insurance company figures are based on "net gain from operations after dividends to policyholders and before federal income tax, excluding capital gains and losses"—the closest measure to pretax net income of corporations generally.

*Industries with less than 8 cases are excluded.

Table 11: Charitable Contributions of 75 Largest Donors as a Percent of U.S. and Worldwide Pretax Net Income, 1983

Company Rank	Contributions[1] (dollars)	U.S. Pretax Net Income[2] ($ Thousands)	Contributions as Percent of U.S. Pretax Net Income	Worldwide Pretax Net Income[2] ($ Thousands)	Contributions as Percent of Worldwide Pretax Net Income
1	$63,356,647	$ 8,900,000	0.71%	$ 8,900,000	0.71%
2	59,047,000	6,100,000	0.97	9,900,000	0.59
3	52,264,000	3,100,000	1.72	9,700,000	0.54
4	46,377,606	2,500,000	1.83	2,700,000	1.74
5	40,100,000	5,300,000	0.76	6,000,000	0.67
6	35,400,000	900,000	3.96	3,400,000	1.04
7	31,174,819	800,000	3.80	1,100,000	2.80
8	27,008,603	1,200,000	2.17	2,900,000	0.92

[1] Direct giving and company foundation pay-outs included; grants made to and retained by company foundations are excluded.

[2] Domestic and worldwide pretax income rounded, percentages actual.

Table 11: Charitable Contributions of 75 Largest Donors as a Percent of U.S. and Worldwide Pretax Net Income, 1983 (continued)

Company Rank	*Contributions[1] (dollars)*	*U.S. Pretax Income[2] ($ Thousands)*	*Contributions as Percent of U.S. Pretax Net Income*	*Worldwide Pretax Net Income[2] ($ Thousands)*	*Contributions as Percent of Worldwide Pretax Net Income*
9	25,783,403	2,400,000	1.09	3,000,000	0.86
10	22,424,300	1,200,000	1.85	1,500,000	1.52
11	19,972,386	1,800,000	1.09	3,400,000	0.59
12	18,200,000	n.a.	n.a.	700,000	2.51
13	17,905,010	1,800,000	0.98	1,900,000	0.95
14	17,551,972	1,200,000	1.50	4,400,000	0.39
15	16,490,002	2,700,000	0.62	2,700,000	0.62
16	15,948,620	n.a.	n.a.	2,800,000	0.56
17	15,086,265	600,000	2.34	700,000	2.07
18	13,679,481	1,000,000	1.36	1,000,000	1.34
19	13,098,659	500,000	2.93	500,000	2.93
20	13,015,437	800,000	1.55	2,300,000	0.57
21	12,825,000	1,400,000	0.92	1,600,000	0.83
22	12,300,000	600,000	2.07	800,000	1.47
23	11,618,750	1,500,000	0.79	1,600,000	0.73
24	10,702,580	50,000	21.93	400,000	2.70
25	10,512,401	n.a.	n.a.	*	*
26	10,361,754	1,500,000	0.70	1,600,000	0.65
27	10,333,863	300,000	3.58	400,000	2.51
28	10,038,000	600,000	1.67	900,000	1.17
29	9,727,099	n.a.	n.a.	500,000	1.93
30	9,711,251	400,000	2.32	600,000	1.70
31	9,602,432	1,500,000	0.63	1,900,000	0.51
32	9,300,000	100,000	6.94	500,000	1.98
33	9,179,580	n.a.	n.a.	2,400,000	0.39
34	9,055,875	100,000	6.16	200,000	5.85
35	9,018,500	200,000	3.94	400,000	2.24
36	8,998,000	500,000	1.97	900,000	1.05
37	8,946,746	300,000	3.09	300,000	3.02
38	8,200,000	n.a.	n.a.	800,000	1.04
39	8,160,000	n.a.	n.a.	2,000,000	0.43
40	8,098,297	200,000	3.52	200,000	3.52
41	7,818,214	300,000	3.00	300,000	3.00
42	7,680,000	500,000	1.58	700,000	1.11
43	7,616,572	600,000	1.21	800,000	1.01
44	7,460,000	600,000	1.15	1,600,000	0.46
45	7,372,113	n.a.	n.a.	500,000	1.63
46	7,339,745	200,000	3.09	300,000	2.80
47	7,308,357	200,000	4.49	300,000	2.32
48	7,287,951	400,000	1.98	400,000	1.78
49	7,203,000	600,000	1.15	700,000	1.04
50	7,176,383	500,000	1.39	600,000	1.25
51	7,102,000	400,000	1.97	400,000	1.81
52	6,894,500	n.a.	n.a.	500,000	1.29
53	6,888,966	500,000	1.37	700,000	1.00
54	6,788,840	300,000	1.84	1,100,000	0.61
55	6,648,657	400,000	1.58	1,000,000	0.67
56	6,496,238	800,000	0.83	1,000,000	0.62
57	6,360,807	300,000	2.29	400,000	1.74
58	6,171,390	*	*	n.a.	n.a.
59	5,953,675	n.a.	n.a.	700,000	0.86
60	5,806,991	n.a.	n.a.	400,000	1.61
61	5,454,373	900,000	0.64	1,100,000	0.51
62	5,397,500	700,000	0.79	700,000	0.79

[1] Direct giving and company foundation pay-outs included; grants made to and retained by company foundations are excluded.

[2] Domestic and worldwide pretax income rounded, percentages actual.

*Company showed loss.

n.a. = Not available.

Table 11: Charitable Contributions of 75 Largest Donors as a Percent of U.S. and Worldwide Pretax Net Income, 1983 (continued)

Company Rank	Contributions[1] (dollars)	U.S. Pretax Income[2] ($ Thousands)	Contributions as Percent of U.S. Pretax Net Income	Worldwide Pretax Net Income[2] ($ Thousands)	Contributions as Percent of Worldwide Pretax Net Income
63	5,318,226	n.a.	n.a.	n.a.	n.a.
64	5,264,830	400,000	1.46	500,000	1.01
65	5,215,150	300,000	1.68	400,000	1.38
66	5,200,585	40,000	14.02	200,000	2.30
67	5,200,000	200,000	2.82	400,000	1.33
68	5,166,351	600,000	0.84	600,000	0.84
69	5,111,587	300,000	1.90	300,000	1.83
70	4,999,300	500,000	1.05	500,000	1.05
71	4,938,364	n.a.	n.a.	300,000	1.63
72	4,937,799	400,000	1.23	400,000	1.16
73	4,746,436	200,000	2.97	700,000	0.73
74	4,742,140	n.a.	n.a.	500,000	0.92
75	4,499,590	100,000	8.16	100,000	8.16

[1] Direct giving and company foundation pay-outs included; grants made to and retained by company foundations are excluded.

[2] Domestic and worldwide pretax income rounded, percentages actual.

n.a. = Not available.

Table 12: Corporate Social Expenditure of 75 Largest Donors as a Percent of Domestic and Worldwide Pretax Net Income, 1983

Company Rank	Total Corporate Social Expenditure[1]	Corporate Social Expenditure As A Percent of		Rank for Charitable[2] Cash Only	Rank for Corporate Assistance[3] Only
		U.S. Pretax Income	Worldwide Pretax Income		
1	$82,547,000	1.35	0.83	1	1
2	67,234,487	9.97	9.97	5	12
3	58,377,337	1.92	0.60	2	5
4	56,827,298	2.24	2.13	3	4
5	40,100,000	0.76	0.67	4	n.a.
6	36,300,000	4.06	1.06	9	40
7	31,174,819	3.80	2.80	46	322
8	28,624,732	2.44	0.64	11	3
9	28,296,263	2.28	0.97	8	30
10	25,783,403	1.09	0.86	6	n.a.
11	23,478,863	8.14	5.71	86	2
12	23,061,386	1.25	0.68	12	15
13	22,424,300	1.85	1.52	7	n.a.
14	21,239,155	n.a.	0.75	14	6
15	18,229,410	2.17	0.86	49	8
16	18,200,000	n.a.	2.51	29	n.a.
17	17,905,010	0.98	0.95	10	n.a.
18	16,490,002	0.62	0.62	13	n.a.
19	15,296,265	2.38	2.10	61	84
20	15,292,203	1.04	0.96	22	9
21	13,700,000	2.31	1.64	18	26
22	13,679,481	1.36	1.34	15	n.a.
23	13,653,552	3.05	3.05	16	55
24	12,963,750	0.89	0.81	19	29
25	12,944,854	26.53	3.27	20	18

[1] Corporate Social Expenditure is the sum of charitable contributions and related corporate assistance expenditures. The latter was collected for the first time in 1982. Many corporations have not yet begun to track corporate assistance expenditures or are only able to provide rough estimates. These data are a useful beginning and suggest an order of magnitude. However they should be used with caution. It will take several years of refinement to bring precision to this measurement effort.

[2] Charitable contributions consist of cash, company product and other property (i.e., land, securities, etc.). This figure reflects only the cash portion of charitable giving. Total charitable contributions appear in Table 11.

[3] Corporate assistance expenditures are not taken by a company as a charitable deduction. The six elements that define corporate assistance for this survey are listed in Table 9.

n.a. = Not available.

Table 12: Corporate Social Expenditure of 75 Largest Donors as a Percent of Domestic and Worldwide Pretax Net Income, 1983 (continued)

Company Rank	Total Corporate Social Expenditure[1]	Corporate Social Expenditure As A Percent of U.S. Pretax Income	Corporate Social Expenditure As A Percent of Worldwide Pretax Income	Rank for Charitable[2] Cash Only	Rank for Corporate Assistance[3] Only
26	12,855,391	n.a.	2.55	24	14
27	12,825,000	0.92	0.83	17	n.a.
28	11,230,705	4.73	4.28	38	11
29	11,224,942	0.85	0.85	23	28
30	11,096,795	0.73	0.59	26	25
31	10,793,000	1.80	1.26	25	45
32	10,512,401	n.a.	*	21	n.a.
33	10,304,251	2.46	1.81	32	53
34	10,103,414	6.88	6.52	31	32
35	9,300,000	6.94	1.98	27	n.a.
36	9,179,580	n.a.	0.39	28	n.a.
37	9,088,297	3.95	3.95	35	36
38	9,018,500	3.94	2.24	45	n.a.
39	8,999,030	1.97	1.05	30	208
40	8,946,746	3.09	3.02	480	n.a.
41	8,693,350	n.a.	0.45	33	56
42	8,327,659	15.11	15.11	63	13
43	8,200,000	n.a.	1.04	34	n.a.
44	8,196,403	n.a.	1.81	37	43
45	7,846,877	n.a.	1.14	50	21
46	7,827,100	2.13	0.71	41	33
47	7,818,214	3.00	3.00	83	n.a.
48	7,768,000	1.20	0.48	36	72
49	7,680,000	1.58	1.11	52	n.a.
50	7,634,899	1.21	1.01	58	162
51	7,308,357	4.49	2.32	499	n.a.
52	7,287,951	1.98	1.78	42	n.a.
53	7,203,000	1.15	1.04	39	n.a.
54	7,198,004	0.47	0.47	40	n.a.
55	7,176,383	1.39	1.25	109	n.a.
56	7,102,000	1.97	1.81	462	n.a.
57	7,058,146	1.98	1.25	448	10
58	6,925,238	0.89	0.67	47	63
59	6,894,500	n.a.	1.29	498	n.a.
60	6,886,966	1.37	1.00	44	n.a.
61	6,777,799	1.61	0.68	43	100
62	6,737,611	2.17	1.79	456	24
63	6,423,766	*	1544.17	48	78
64	6,376,368	2.30	1.75	485	170
65	5,876,991	n.a.	1.63	51	124
66	5,865,000	0.54	0.54	463	38
67	5,695,170	2.24	2.24	287	7
68	5,454,373	0.64	0.51	64	n.a.
69	5,397,500	0.79	0.79	53	n.a.
70	5,318,226	n.a.	n.a.	62	n.a.
71	5,264,830	1.46	1.01	476	n.a.
72	5,202,300	1.10	1.10	57	86
73	5,200,585	14.02	2.30	203	n.a.
74	5,200,000	2.82	1.33	54	n.a.
75	5,166,351	0.84	0.84	55	n.a.

[1] Corporate Social Expenditure is the sum of charitable contributions and related corporate assistance expenditures. The latter was collected for the first time in 1982. Many corporations have not yet begun to track corporate assistance expenditures or are only able to provide rough estimates. These data are a useful beginning and suggest an order of magnitude. However they should be used with caution. It will take several years of refinement to bring precision to this measurement effort.

[2] Charitable contributions consist of cash, company product and other property (i.e., land, securities, etc.). This figure reflects only the cash portion of charitable giving. Total charitable contributions appear in Table 11.

[3] Corporate assistance expenditures are not taken by a company as a charitable deduction. The six elements that define corporate assistance for this survey are listed in Table 9.

*Company showed loss.

n.a. = Not available.

Table 13A: Contributions as a Percent of U.S. Pretax Net Income—Quartile Rank, 1983

Companies Grouped by Industry Class (with at least ten cases in each)

		Contributions Ratios[1]		
Industrial Classification	*Number of Companies*	*Lower Quartile*	*Median*	*Upper Quartile*[2]
Chemicals	25	1.34%	1.65%	2.68%
Electrical machinery and equipment	28	0.71	1.19	3.23
Fabricated metal products	10	0.96	1.09	1.69
Food, beverage and tobacco	25	0.71	0.94	1.91
Machinery, nonelectrical	11	0.35	1.25	12.41
Paper and like products	12	0.51	1.01	2.82
Petroleum and gas	15	0.83	1.50	1.83
Banking	45	1.10	1.61	2.74
Insurance	41	1.02	1.77	2.95
Retail and wholesale trade	12	0.79	1.30	2.91
Telecommunications	19	0.33	0.50	0.62
Utilities	52	0.19	0.29	0.52

[1] The statistics presented here are derived only from companies with positive net income.

[2] This is the 75th percentile.

Table 13B: Contributions as a Percent of Worldwide Pretax Net Income—Quartile Rank, 1983

Companies Grouped by Industry Class (with at least ten cases in each)

		Contributions Ratios[1]		
Industrial Classification	*Number of Companies*	*Lower Quartile*	*Median*	*Upper Quartile*[2]
Chemicals	29	0.82%	1.25%	1.66%
Electrical machinery and equipment	34	0.68	1.02	2.00
Fabricated metal products	10	0.77	0.90	1.54
Food, beverage and tobacco	28	0.59	0.88	1.62
Machinery, nonelectrical	15	0.77	1.25	2.72
Paper and like products	16	0.68	0.90	1.70
Petroleum and gas	20	0.40	0.55	0.68
Pharmaceuticals	16	0.65	0.96	1.11
Printing and publishing	11	0.62	0.96	1.14
Textiles	11	0.67	1.38	1.99
Transportation equipment	13	0.54	0.69	1.43
Banking	53	0.95	1.42	2.27
Insurance	46	0.97	1.74	2.89
Retail and wholesale trade	16	0.79	1.01	2.84
Telecommunications	19	0.33	0.50	0.62
Utilities	56	0.19	0.30	0.50

[1] The statistics presented here are derived only from companies with positive net income.

[2] This is the 75th percentile.

Table 14A: Contributions as a Percent of U.S. Pretax Net Income—Quartile Rank, 1982

Companies Grouped by Size of U.S. Income

		Contributions' Ratios[1]		
U.S. Pretax Net Income	*Number of Companies*	*Lower Quartile*	*Median*	*Upper Quartile*[2]
Below $5 million	11	3.71%	5.58%	41.16%
$5-9.9 million	19	1.90	2.28	3.50
$10-24.9 million	52	0.91	1.62	2.86
$25-49.9 million	51	0.91	1.33	2.03
$50-99.9 million	73	0.49	0.96	1.60
$100-249.9 million	58	0.48	0.83	1.67
$250-499.9 million	52	0.37	0.85	1.58
$500-999.9 million	28	0.33	0.81	1.51
$1 billion and over	24	0.46	0.78	1.29
All Income Groups	**368**	**0.63**	**1.12**	**1.97**

[1] The statistics presented here are derived only from companies with positive net income.

[2] This is the 75th percentile.

Table 14B: Contributions as a Percent of Worldwide Pretax Net Income—Quartile Rank, 1983

Companies Grouped by Size of Worldwide Income

		Contributions' Ratios[1]		
Worldwide Pretax Net Income	*Number of Companies*	*Lower Quartile*	*Median*	*Upper Quartile*[2]
Below $5 million	12	4.04%	8.46%	57.91%
$5-9.9 million	19	1.90	2.72	3.50
$10-24.9 million	58	0.91	1.62	2.52
$25-49.9 million	49	0.70	0.98	1.68
$50-99.9 million	85	0.48	0.95	1.48
$100-249.9 million	81	0.49	0.80	1.26
$250-499.9 million	64	0.36	0.72	1.61
$500-999.9 million	42	0.32	0.76	1.06
$1 billion and over	34	0.45	0.59	0.84
All Income Groups	**444**	**0.52**	**0.94**	**1.65**

[1] The statistics presented here are derived only from companies with positive net income.

[2] This is the 75th percentile.

Table 15A: Contributions as a Percent of U.S. Pretax Net Income—Quartile Rank, 1983
Companies Grouped by Size of U.S. Assets

		Contributions' Ratios[1]		
Assets	*Number of Companies*	*Lower Quartile*	*Median*	*Upper Quartile*[2]
Below $100 million	6	0.84%	2.85%	6.35%
$100-199 million	20	0.72	1.68	3.43
$200-299 million	17	0.77	1.28	2.35
$300-499 million	31	0.55	1.08	1.78
$500-999 million	48	0.50	0.81	1.48
$1-1.9 billion	63	0.70	1.25	1.77
$2-2.9 billion	42	0.45	1.19	2.17
$3-3.9 billion	24	0.68	1.39	2.99
$4-4.9 billion	11	0.27	0.79	1.00
$5-9.9 billion	47	0.34	1.36	1.85
$10 billion and over	36	0.62	1.07	2.08
All Asset Groups	**345**	**0.61**	**1.10**	**1.97**

[1] The statistics presented here are derived only from companies with positive net income.
[2] This is the 75th percentile.

Table 15B: Contributions as a Percent of Worldwide Pretax Net Income—Quartile Rank, 1983
Companies Grouped by Size of Worldwide Assets

		Contributions' Ratios[1]		
Assets	*Number of Companies*	*Lower Quartile*	*Median*	*Upper Quartile*[2]
Below $100 million	6	0.89%	2.85%	6.35%
$100-199 million	23	0.71	1.07	2.72
$200-299 million	24	0.70	0.98	2.24
$300-499 million	36	0.65	0.94	1.53
$500-999 million	57	0.49	0.84	1.42
$1-1.9 billion	71	0.50	0.91	1.61
$2-2.9 billion	51	0.49	1.02	1.90
$3-3.9 billion	32	0.52	0.97	1.74
$4-4.9 billion	23	0.46	1.00	1.88
$5-9.9 billion	61	0.32	1.04	1.63
$10 billion and over	59	0.57	0.82	1.47
All Asset Groups	**443**	**0.52**	**0.95**	**1.65**

[1] The statistics presented here are derived only from companies with positive net income.
[2] This is the 75th percentile.

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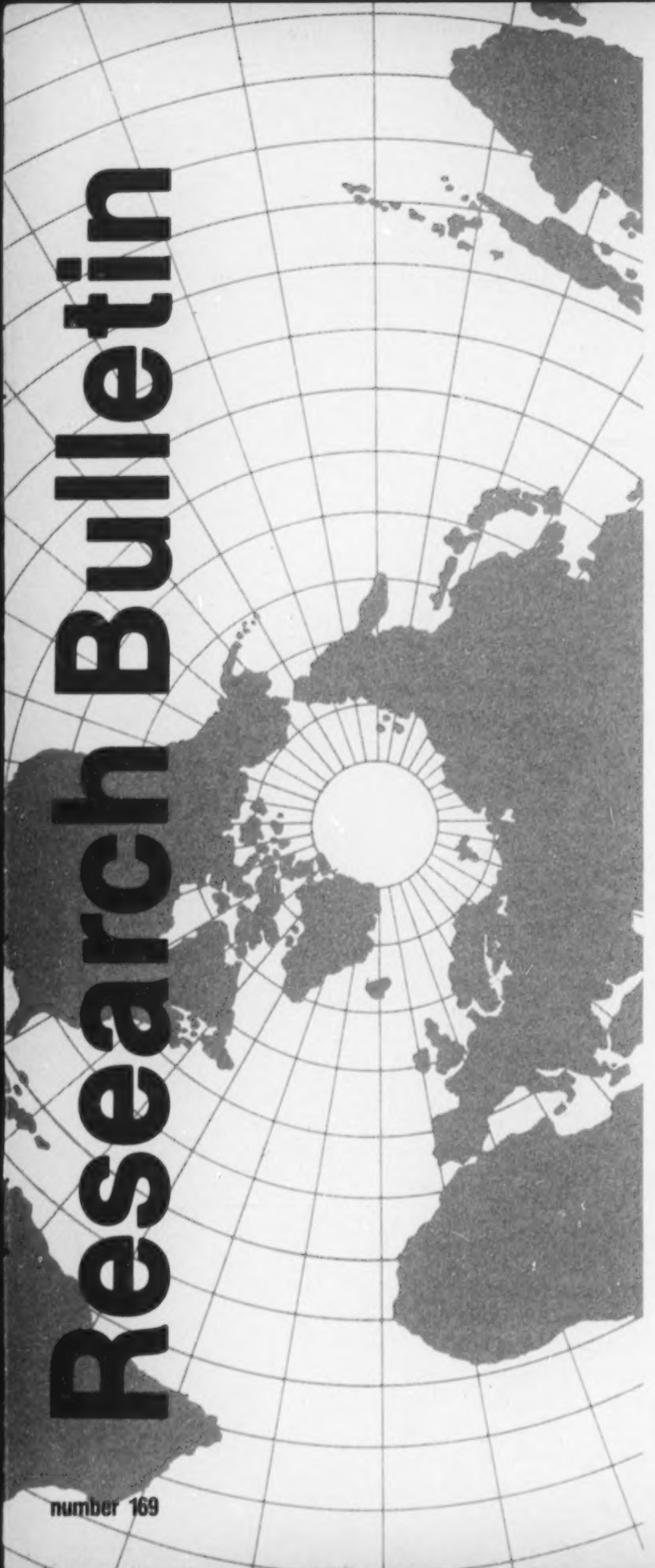

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1985 International Economic Outlook

Views of U.S. Corporate Planners

by John Hein

The Conference Board

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"Between now and the end of next year, important differences in developments among the different regions of the OECD economy are likely to continue," the Organization for Economic Cooperation and Development, which encompasses the 24 major industrial countries, noted in its semiannual *Economic Outlook* this past July. "The probable outcome for the United States, on present policies, is considered to be a slowing of the expansion . . . . In Japan, too, the period of fastest expansion may already be passed, but the domestic recovery there, although modest, could be more sustained . . . . In Europe, where the recovery started late, it remains fragile and appears unlikely to accelerate to a rate that would bring about a significant reduction in the level of unemployment by end-1985."

Against the background of this official evaluation, shown in greater detail in Table 1, The Conference Board asked economists, planners and analysts in U.S. private industry to submit their own views regarding the economic outlook abroad for 1985. As in previous years, the panel members were asked for their assessment of economic prospects in the countries "that are important to your company's foreign operations or on which you normally gather information." The following report, the ninth in this series, is based on the replies received from respondents in twelve major business organizations. Eight of these are among the two hundred largest U.S. industrial corporations as listed by *Fortune*; four are prominent in the financial and transportation sectors.

Most of the data and the qualitative assessments that were submitted were originally prepared for internal corporate use, and generally reflect the companies' major areas of activity, both geographically and in terms of products. Moreover, the data merely indicate the ranges within which certain estimates might fall in the near term or, as one respondent wrote in 1982, "what we regard as the most likely course through the company's planning period." Major corporations do continue to prepare and rely on such assessments—despite the *Wall Street Journal*'s remark this September that "the deepening skepticism about the usefulness of economic advice is leading some companies to drop in-house forecasting." In fact, one in-house economist who contributed to the current survey writes: "This year finds us a bit smug, since our previous year's forecasts seem pretty much on track. We have some longer-term concerns, but they are not overwhelming and are far enough in the future so that a prudent forecaster would not spend too much time stewing over them."

General Overview

The general tone that ran through the responses was set by one panelist: "Economic activity continues to show gradual gains in most industrial countries outside the United States, generally led by improved exports. The United States has served as the locomotive to the current global recovery, its strong import demand creating improved markets for both industrial and developing countries' exports. Led by growth of exports, augmented in some countries by investment spending, Europe's gradual pace of recovery showed signs of accelerating. In Canada, the rate of activity is slowing, paralleling the slowing pace of the U.S. recovery. Based on improved exports, Japan's output is growing at a stronger-than-expected 4.5 percent this year.

"The major countries of Latin America continue in recession, with growth constrained by their debt-service burden and excessive rates of inflation. The developing and emerging industrial countries of Asia, heavily dependent on exports, are participating in the generally improving global economy." Based on this somewhat cautious assess-

Table 1: Official Growth and Inflation Forecast (Percentage changes, annual rates)

	From Previous Year		*From Previous Half Year*		
	1984	*1985*	*1984*	*1985*	
			Second Half	*First Half*	*Second Half*
Growth of Real GNP					
United States	6.0	2.5	3.25	2.5	2.5
Canada	4.5	3.0	3.5	3.0	2.25
Japan	4.75	3.75	4.0	3.75	4.0
France	1.25	1.75	1.5	1.75	2.0
Germany	3.0	2.75	2.75	2.5	3.0
Italy	2.25	2.25	2.0	2.0	3.0
United Kingdom	2.5	2.25	3.5	2.0	2.0
All seven countries	4.5	2.75	3.0	2.5	2.75
Other OECD countries	2.75	2.5	2.5	2.5	2.5
Total OECD	4.25	2.75	3.0	2.5	2.5
GNP Deflators					
United States	4.0	4.75	4.5	5.0	5.0
Canada	4.5	5.0	4.5	5.5	5.0
Japan	1.5	2.0	1.75	2.0	2.5
France	8.0	6.0	6.75	6.0	5.5
Germany	2.75	3.0	2.5	3.0	3.0
Italy	11.25	8.25	9.5	8.25	7.25
United Kingdom	5.0	5.0	5.25	5.0	5.0
All seven countries	4.25	4.5	4.25	4.5	4.5
Other OECD countries	8.5	7.25	8.0	7.25	7.0
Total OECD	5.0	5.0	5.0	5.0	5.0

Source: Organization for Economic Cooperation and Development, *Economic Outlook*, July, 1984.

ment, this analyst offers the following forecast for real GNP growth for the world's major regions:

	1984	*1985*
United States	7.1%	4.2%
Canada	4.5	2.8
Europe	1.9	1.9
Latin America	–1.5	0.1
Asia–Pacific	4.9	4.5

A second respondent provides a somewhat broader picture that included both a backward glance and a look beyond 1985: "The accompanying table reveals how absolutely grim the five years which ended in 1983 were for all major areas. Even when the recovery year of 1983 is factored in, industrial production had advanced barely at all from 1978 levels, except in Asia. The second revelation of the table is how much better we expect the next five years to be. This does not imply that we forecast an end to all future recessions. But we do not expect the next five years to include more than nine to twelve months of bad times, in contrast to the very atypical twenty-four to thirty-six months of bad news that gripped the world economy during 1978–83."

Industrial Production
(Average annual change, in percent)

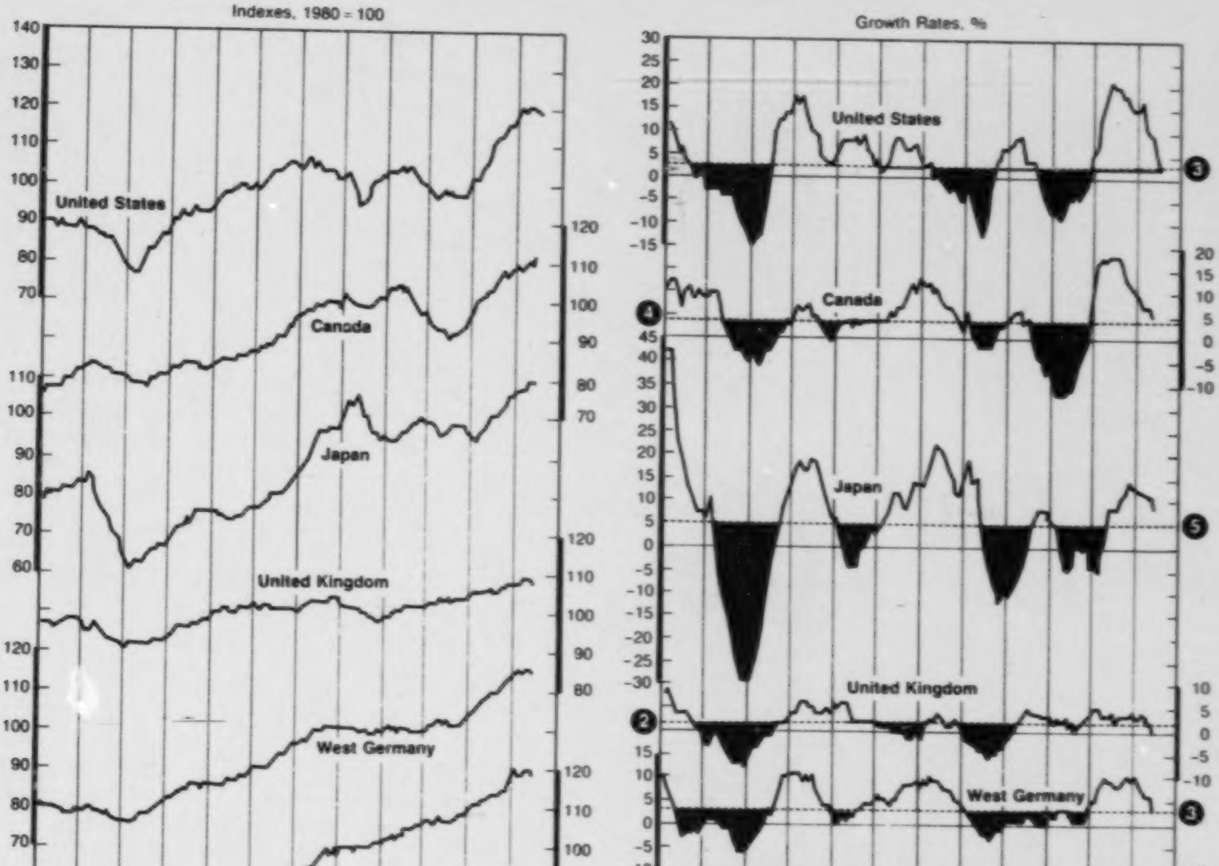
			(Estimated)	
	1978–83	*1983*	*1984*	*1984–1989*
United States	0.3%	6.4%	11.3%	4.5%
Europe	–0.1	0.4	2.5	2.3
Asia	4.6	7.0	13.8	5.9
Americas	1.9	–0.8	1.8	2.2

The crucial role of the United States is stressed by another panelist: "The recovery in most countries has been fueled by exports to the United States, and the outlook for 1985 thus depends in large measure on the growth of our domestic economy and the strength of the dollar. Since neither is likely to be as strong in 1985 as in 1984, our major trading partners will have to depend on uncertain increases in internal demand to offset the slower growth of exports."

Still, comments a fourth respondent: "At this juncture in the business cycle, it is premature to forecast another recession in Europe in 1985. While policy decisions in the last half of the year could prove overly restrictive, leading indicators and recent policy changes suggest continued overall expansion at a lower growth rate in 1985, relative to 1984, as the recovery matures."

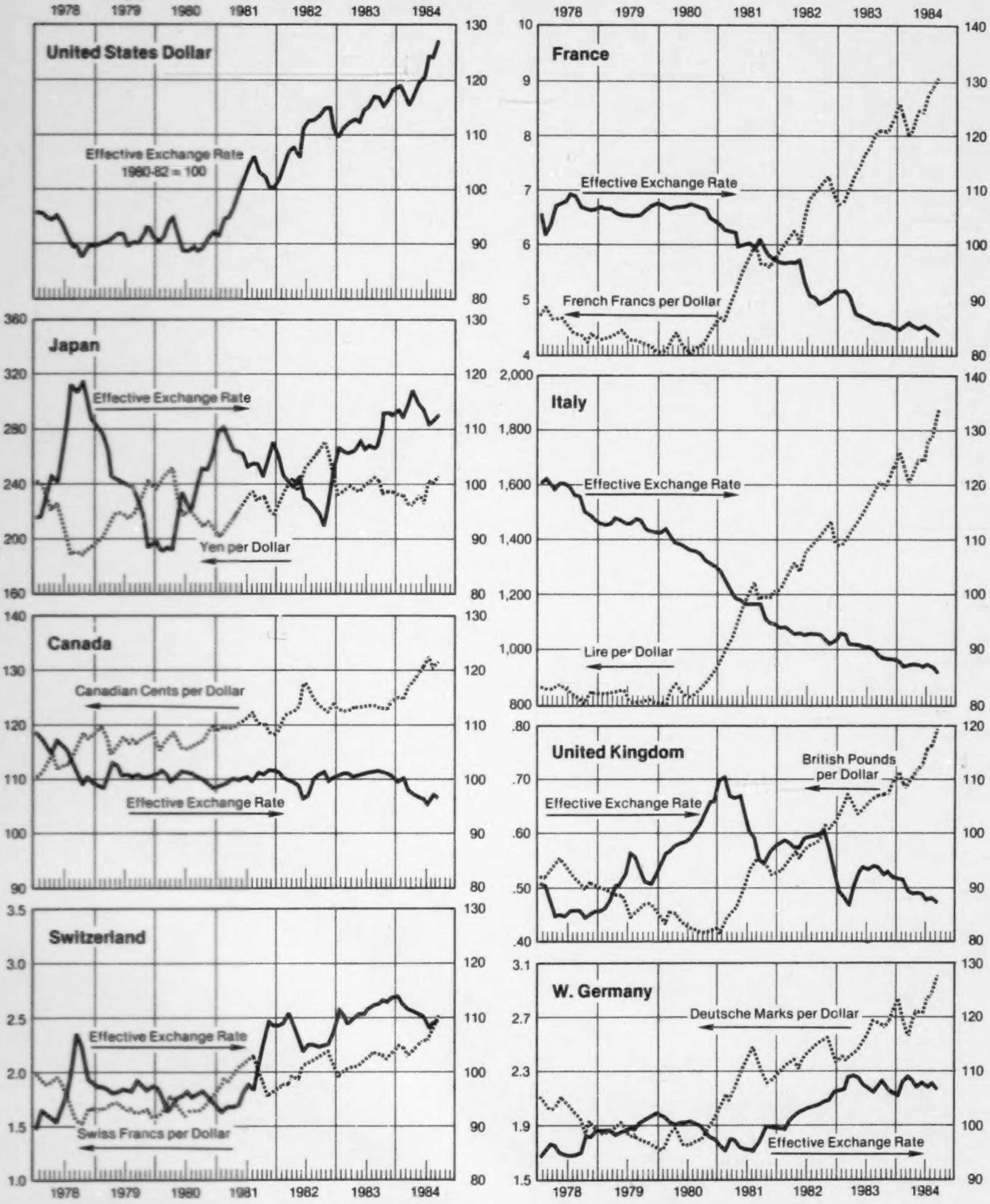
The relative strength of activity in the six major industrial countries outside the United States was confirmed by The Conference Board's *International Economic Scoreboard*, which noted in August that the combined index of leading indicators for those countries was rising faster than the U.S. index for the first time since the current recovery began. "The U.S. rate has slowed to five percent, while the six-country rate is seven percent. Japan, with an 11-percent growth rate is the front-runner, and the leading indexes for France, Germany and Italy are also rising faster than the U.S. index." These rates (which are annualized ratios of the latest month's index to the average index over the preceding twelve months) as well as the leading indexes themselves are shown in Chart 1.

Chart 1: Leading Business Cycle Indexes



Note: Horizontal dash lines are average growth rates for 1969-79 in the index and in real GNP
Source: The Conference Board

Chart 2: Foreign Exchange Rates



Note: Nominal Effective Exchange Rates: Index numbers 1980-82 = 100. Each index shows a currency's trade-weighted appreciation or depreciation measured against fifteen other major currencies using averages of daily noon spot exchange rates in New York and bilateral trade weights based on 1980 trade in manufactures.

Source: Morgan Guaranty Trust Co.

The Role of the Dollar

The strength of the dollar vis-à-vis other major currencies (shown in Chart 2) plays an important part in virtually all respondents' outlooks for the coming year. It is worth recalling that in last year's survey the panel generally had predicted that the dollar would remain strong throughout 1984. (Examples: "We are talking about a currency which the sheer weight of numbers places in a category by itself"; and "The dollar is unlikely to face any devaluation from its current level in 1984.") This had been in sharp contrast to the view expressed by some government officials and several publications that a deteriorating trade and current-account balance eventually would sink the dollar "of its own weight."

This issue is taken up by one of this year's panel members: "The burgeoning U.S. trade deficit (expected to reach some $120 billion) with an associated current-account deficit (estimated at near $90 billion) would normally exert considerable downward pressure on the dollar's value. However, real short-term interest rates in the United States have risen further in recent months and are currently 3 to 5 percentage points above those of other key countries. This substantial disparity in real interest rates continues to generate global demand for dollars and is one of the primary factors behind the exceptionally strong dollar. Until there is a significant decline in real interest rates in the United States relative to other major countries, any depreciation of the dollar will probably be quite limited."

Another panelist adds a further dimension: "More than ever before, the decisions of international investors reflect their judgment about the economic outlook of various countries and their chances of mastering the persistently serious problems of recent years. The foreign-exchange markets have begun to take into consideration a wide spectrum of factors relating to the different countries' economies rather than the traditionally monitored variables, such as interest differentials and the balance of payments."

Any correction in the dollar's exchange rate in the near future is believed to be gradual at best. "The key word," one contributor writes, "is 'gradual,' acknowledging the fact that the timing of the exchange market's response to the winding down of the business cycle is by no means guaranteed. Analysts have been calling for the dollar's retreat since early 1983. At this point, there is much more consensus on a downward correction of the dollar than on its magnitude. For planning purposes, we are looking for a nearly 10-percent depreciation of the dollar against the D-mark and approximately 13 percent against the yen by 1986."

The adverse effects of a strong dollar on corporate activity and performance do not go unnoticed by an analyst with a chemical company: "The U.S. dollar could remain relatively strong over the remainder of the decade, given continuing high U.S. budget deficits and double-digit prime interest rates. A strong dollar thus cuts into earnings per share when foreign profits are translated into dollars."

Comments another contributor from a machinery producer: "The high value of the dollar has forced us to go abroad to manufacture and survive in foreign markets, and is leading us to bring that material back into the United States. The 'cost' to the United States will linger for a generation or more. Perhaps it simply has accelerated a structural trend. I doubt that 5 percent of Americans understand the tremendous structural impact this is having on 'known technology' industries. We have moved operations abroad and gone into joint ventures that we would never have considered otherwise. Moreover, the local talent in foreign countries has grown to the point where we do not use Americans abroad. This arrangement works and our costs are far lower."

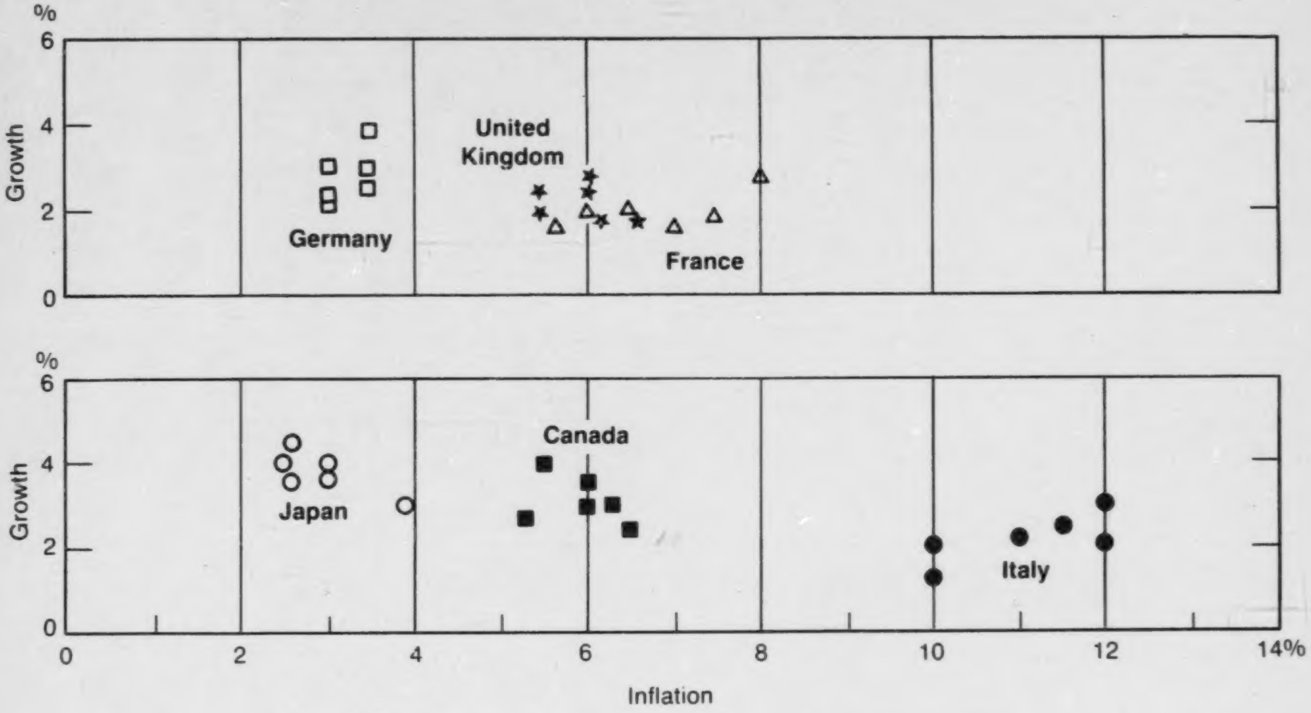
One panel member recalls that the election of Ronald Reagan in 1980 "meant that, for the first time in more than a decade, international capital was paid very generously for investing in dollars, and was comfortable doing so. But how long can this situation last? In theory, I suppose, it could continue for years. For example, the Canadian dollar was at a premium over the U.S. dollar for decades after World War II, in large part thanks to massive and continuing capital inflows from the United States—until the diminution of this capital flow sent the Canadian dollar to a discount. In practice, I'm convinced that this inherently unhealthy situation cannot last: Capital cannot indefinitely be paid so generously for doing nothing, for rolling over T-bills risklessly. Trade and current-account deficits cannot expand indefinitely without bringing about a market reaction both at home and abroad among affected industries and their workers, as well as affecting our ability to service debt and the desire of others to lend to us. Rickety debtor-nation balance sheets cannot be shored up indefinitely by accounting and linguistic gymnastics while interest costs keep rising."

Major Industrial Countries

This section presents the views of the panelists on the outlook for the six major industrial countries outside the United States. Each country section is prefaced by a brief quotation from the "official" outlook of the OECD, released this July. This technique serves to highlight the often diverse—and at times even offbeat—concerns of the panel members regarding individual countries.

The panel's assessment of the outlook for the six countries pointed, of course, in the same general direction as the OECD's outlook, although views differed as to the actual growth and inflation rates foreseen for 1985. Some of these projections are shown in Chart 3, in order to illustrate the range of the "most likely course" anticipated.

Chart 3: **Growth and Inflation in Six Countries, Forecasts for 1985**



Observations represent forecasts for growth and inflation rates in 1985 submitted by individual panelists.

Canada

> **"As in the United States, the overall shape of the recovery has largely conformed with average pre-1983 experience . . . . A prospective slowing of domestic demand, which would be aggravated by a further rise in interest rates abroad, highlights the importance of export markets at this juncture for sustaining the upswing and thereby inducing business investment as capacity utilization rises."**
>
> **OECD Economic Outlook**

The close connection between economic activity in Canada and the United States invariably continues to color the statements of both Canadian officials and the members of The Conference Board panel. Thus, Gerald K. Bouey, Governor of the Bank of Canada, remarked in June that events in the United States had been the main source of pressures in Canadian financial and exchange markets. He said: "I would not want this emphasis on the United States to obscure the very real issues facing Canadians over time. . . . However, because of the size and importance of the U.S. economy, the essential problem from a global perspective is the fiscal situation and prospects for the United States. Because of high interest rates, investment needed to ensure future growth in the world economy is being inhibited."

Similar concerns were voiced by the panelists—all of whom, it should be noted, prepared their comments before the September 4 election victory of the Conservative Party. "The Canadian recovery," one writes, "is losing some of the momentum built during 1983. Consumption spending is slowing to a more moderate pace, and business capital spending has shown little real growth since the recession trough. While exports have benefited from the strength of the U.S. recovery, the weakening of the Canadian dollar could result in slightly higher inflation for 1985."

Another comments: "The Canadian recession had been much deeper than those experienced by the other major countries; initially the recovery was also faster, assisted by an expansionary fiscal policy. Capital spending, however, remains very weak, held back by low utilization rates as well as by a serious lack of business confidence in future growth prospects. Without a boost from government spending, overall investment would be lower still."

A third view is even more pessimistic: "Consumer and business confidence have faltered; the federal budget deficit is higher than that in the United States as a proportion of GNP; and expansion of the export sector, the main source of growth in recent quarters, will likely slow as the United States, with whom Canada does about 75 percent of its trading, experiences a deceleration in economic growth. With little likelihood of major inventory accumulation against a prime rate of 13.5 percent, with the recent drop in the Canadian dollar adding inflationary pressures, and with commodity prices off substantially since year-end, we believe GNP growth this year could be as little as 3.5 percent, and lower still in 1985."

Looking ahead to the impending election, another panelist sees reason for hope, both for Canadian business and for mending fences with the United States: "Either Turner or Mulroney will improve the outlook for business and the economy. Some likely changes: scrapping or severe weakening of the Foreign Investment Review Agency (FIRA); extensive modifications to the National Energy Program (NEP); and better trade relations with the United States. Changes have already started, but a new Prime Minister will accelerate them."

Japan

"Growth in 1984 is likely to be stronger than for a number of years . . . . Given increased rates of capacity utilization, much higher profits, and the continued wave of technological innovation, the recovery could well be sustained into 1985."

OECD Economic Outlook

Private commentators, including The Conference Board's panel, often underscore various unusual features of the Japanese economy. A major French bank noted earlier this year that the economic indicators for Japan suggested a privileged country, with an annual growth rate of around 3 percent, a trade surplus of over $20 billion, inflation running at 1.8 percent, and unemployment as low as 2.6 percent. "And yet the Japanese do not seem content . . . . Conventional macroeconomic indicators and technological performance are inadequate as pointers to Japan's future owing to the many peculiarities of this Asian country, often wrongly suggested as a model for Europe."

At the turn of the year, the Japan Economic Research Center had commented similarly (in its *Quarterly Forecast No. 55*) that "the realities of life are usually full of contradictions. The real substance of long-term problems stands out prominently. Savings to the magnitude of 8 trillion yen remain idle without being put to practical use. Also, there is an excess supply capacity to the extent of 10 trillion yen. Trade frictions are intensifying. As long as neither Japan nor the United States is willing to make any concessions in their respective positions, then there will be no changes in this trade structure: a deficit of $100 billion for the United States and a surplus of $45 billion for Japan" (projections for 1984).

Several problem areas for the Japanese economy surface in the panel's comments. "Japan is beginning to experience overcapacity in steel, shipbuilding, petrochemicals and textiles. Also, Japan is vulnerable from the growing war between Iran (from which Japan receives its oil) and Iraq, as well as from growing worldwide protectionist trends."

Another respondent notes: "The Japanese economy will face a difficult year in 1985 as growth shifts away from exports. A further challenge will come from the need to roll over an unusually large amount of government bonds; this may require the government to offer a higher, more internationally competitive interest rate. The recent agreement with the United States, which calls for an acceleration of the liberalization of Japan's financial markets, also implies rising domestic interest rates. Since Japanese companies are much more highly leveraged than those in other countries, this may lead to a significant slowdown in the growth of private investment."

Another respondent also comments on some implications of the Japanese interest rate level: "On external account, Japan's problem has been one of success. From a domestic point of view, however, the authorities would have preferred to reduce interest rates more quickly in order both to stimulate economic activity and to ease the cost of financing the public-sector deficit. But with Japan's current account moving into a large surplus, such action might have been interpreted as pursuing a 'cheap yen' policy—and that concern clearly has inhibited a reduction in interest rates."

France

"If present economic policy is pursued, further progress should be achieved in 1984–85. Given wage restraint and the expected slow rise in import prices, inflation could be brought down in 1985 to the OECD average, compared with the differential of nearly four points in 1983. However, this can be achieved only through sharply curbed domestic demand and, probably, a substantial deterioration in labor market conditions. The various existing schemes to reduce unemployment will cease producing additional effects next year. If these are not supplemented, the unemployment rate will probably rise rapidly during the forecast period, perhaps to almost 11 percent by year-end 1985."

OECD Economic Outlook

The Mitterand government remains determined to modernize the state-owned sector—which is now estimated to comprise perhaps as much as half of all French business activity—and to make it more profitable and more competitive, even at the risk of higher unemployment. Yet, this program would certainly take longer than the political timetable allows: Parliamentary elections are due in 1986. While opinion polls in France have shown that the current austerity program is highly unpopular, some European observers have detected certain improvements in the French economy, including a slowing of inflation, a reduction in the trade deficit, and better financial results for some nationalized companies. The austerity budget introduced in mid-September aims at consolidating these improvements.

The Conference Board's panel proved to be almost equally divided between optimistic and gloomy views. "We continue to believe that France's economic recovery remains on track," one panelist wrote. "Following positive real GNP growth in 1983 of 0.9 percent, we now believe that 1.5 to 2-percent growth can be achieved this year and next. In our view, it is still too early to gauge the effect of Germany's shorter workweek on French unions."

Another respondent elaborates on this favorable scenario: "Signs are appearing that point to a better outlook for 1985. The government expects to continue curtailing its expenditures to keep the budget deficit below a targeted ceiling of 3 percent of gross domestic product. In the private sector, export sales have already generated a recovery in profits, leading to a sharp upward revision in business-investment plans. In addition, the government has promised a one percentage point cut in personal income-tax rates, which would bolster disposable income. As ongoing progress in reducing inflation buoys confidence, this boost to income could encourage spending and bring added investment activity."

A somewhat contrary view is expressed by another panel member: "The proposed 1985 fiscal stance indicates another year of weak (1 to 2 percent) economic growth. Having made the U-turn from fiscal expansion to austerity, the government's guidelines for the 1985 budget call for another year of restrictive fiscal policy. Preliminary government-expenditure ceilings call for a 10 percent (before inflation) cut in government capital spending, as well as lesser cuts in current spending. These spending reductions will be used to finance tax cuts.

"With parliamentary elections coming in 1986, the government may find it difficult to carry out another year of austerity. Its popularity is low and social tensions are high. Gross investment has been depressed and will provide only a moderate economic stimulus in 1984-1985. About half of total gross investment is construction. Housing starts are at a record low, due to depressed real incomes and adverse social legislation that have reduced residential investment incentives. Public construction is not likely to escape the planned 10-percent cut in government capital spending next year."

A slightly different aspect is discussed by a fourth respondent, namely, France's "traditional vulnerability to imported inflation." He notes that in virtually all post-World War II "crises"—such as the Korean War, the Suez crisis of 1956, and the two oil-price increases of the 1970's—consumer prices in France always rose by more than those in the rest of the industrial world. However, he also finds an important difference between the earlier and the later parts of this entire period. From 1950 until the late 1960's, "sudden price flareups were followed by corresponding downturns. Since the first oil crisis, decreases have been smaller than increases. With this breeding ground for inflation, breaking the price-wage spiral represents no mean challenge for France today."

Germany

"The rise in the average growth rate since 1982 is attributable mainly to foreign demand, the contribution of the real foreign balance moving from an annual rate of more than minus 1 percent in early 1983 to more than plus 1 percent of GNP in 1985. With capacity utilization rising rapidly, machinery and equipment investment seems likely to gain momentum, but construction investment is forecast to decline in 1985, while the expansion of private consumer demand will remain dampened by the fiscal impact on disposable household incomes."

OECD Economic Outlook

Earlier this year, *The Economist* commented that German travelers visiting Britain in the early nineteenth century felt that Germany could never hope to emulate the British economic miracle of the industrial revolution. These days, by contrast, "a British traveler returning from Germany has to report that that country's postwar miracle, so resplendent in the 1960's and still impressive in the 1970's, seems to be fading." The analysis commented further on "a state of mind adverse to risk-taking," on the social safety net having become "a social hammock," and on businessmen reluctant to innovate.

Similar uncertainties color some of the replies of the panel members, all of which were drafted before German Finance Minister Stoltenberg announced continued fiscal austerity for 1985. As one writes: "The government has improved financial market conditions by reducing the public-sector deficit, but has also weakened the incentives to work and to invest by raising tax rates and social contributions. Much uncertainty attaches to the 1985 forecast because of the difficulty of anticipating future policy measures and exchange-rate developments. The timing of economic policy actions is especially hard to foresee. It is, therefore, difficult to predict when the damping elements will fade and real improvement take place."

"Germany has bounced back well from the recent metal workers' strike," a second respondent writes, "but longer-term problems remain. While the srike has not killed the recovery, it has set the stage for lower economic growth in 1985 and a more uncertain economic environment in the late 1980's. The higher costs resulting from the 38½-hour workweek will weaken investment incentives and reduce real GNP growth to 2 percent in 1985. Slower growth will worsen the unemployment situation. There will be some upward pressure on prices and we look for a 2.5 percent inflation rate this year, followed by 3 percent in 1985."

This Spring's strikes, the most severe labor action since 1978, also give pause to another respondent: "The confrontation was in direct contrast to the normally cooperative labor movement, and highlights labor's desire to find a solution to high unemployment. While most of the production lost during the strike can be made up in the coming months, the consequences are more difficult to assess in terms of eroded business and consumer confidence."

A fourth panel member expresses the belief that Chancellor Kohl's conservative government will generally maintain its "pro-business policies," but still remains pessimistic as to the near-term outlook: "By early 1985, quarter-to-quarter growth rates for the total economy will decrease. Such slower growth by early 1985 is largely due to two factors. First, after the initial recovery from a low base, quarter-to-quarter comparisons are from higher levels. Second, and more important, monetary policy has turned relatively more restrictive during the past six to nine months. The money supply has been virtually flat and the central bank's money creation has been quite a bit slower than during the corresponding quarters of 1983. Interest rates have not moved up much this year because of reduced public-sector borrowing, although bank liquidity has decreased. There is ample room for monetary stimulus during the coming months without jeopardizing price stability, although exchange-rate effects must also be considered."

Italy

"The present recovery could prove to be relatively sustainable though moderate, with GNP growing by 2.25 percent a year in 1984 and 1985. The deceleration in inflation expected over the next eighteen months, to an 8 percent increase in 1985 for consumer prices and wages, represents a break from the trend of the 1970's. This forecast allows for the effects of measures taken in mid-February and mid-April introducing a ceiling on index-linked wage increases."

OECD Economic Outlook

Private observers do not generally share such a relatively rosy view of Italy's economic prospects, especially in the long run. In his company's newsletter (*Orientation*, October 1983), the chief economist of a major Italian insurance company discussed three major problems that required urgent solutions—rent control, which continued to distort the housing market; inequities in the tax system, which permitted widespread tax evasion, particularly by the self-employed; and the lopsided and overgenerous social-security system. He continued: "Politicians would be utterly wrong in dismissing the common man's uneasiness about these three problems, as well as his despondence over the malfunctioning . . . of many services, such as health, justice, public transport, etc. Not to mention the taxpayer's resentment for daily witnessing the expense and waste that take place at every level of the administration, with a profusion of initiatives of doubtful value, though labeled as resounding social or cultural aims."

Looking only as far ahead as 1985, the panel members likewise see reason to be concerned. "Italy's recovery, like that of France," one member writes, "has lagged those of the other major industrial countries, as growth has been held back by the need to bring inflation under control. Overall, the recovery in Italy is more fragile than elsewhere. Government borrowing needs have consistently exceeded targets; sustained recovery will depend on firmer control."

Another respondent notes: "Italy is experiencing a moderate economic recovery that will produce a real GNP growth close to 3 percent in 1984, slowing to 2.5 percent in 1985. Exports are the driving force behind the upturn, while investment growth is limping along at 3 percent per year. Inflation is decelerating rapidly (11 percent in 1984 as against 16 percent in 1983), but it has now reached a strong resistance point. Inflationary expectations are rising as wages increase faster than the government's inflation targets. We currently forecast a 10.5 percent inflation rate in 1984 and 1985. The size of the public debt (15 percent of GNP) continues to be Italy's major problem and the frequency of government changes prevents progress in this area."

Inflation and the effects of the budget deficit also are cited by another respondent: "Ten years of double-digit inflation have led economic agents to base their price and cost forecasts on high inflation expectations. Such behavior, which affects discussions about modifying the indexing of wages, is difficult to change. In addition, strong inflationary pressures are exerted by government expenditures and revenue—over and above the direct effects of inflation on the budget deficit. Strong fiscal drag at a time of sharp price increases has generated increasingly high pay claims. As a result, monetary policy is dominated by fiscal problems and the central bank has no alternative but to finance the deficit."

Another panelist, who also cites "the misallocation of resources caused by the budget deficit," shows some cautious optimism: "The short-term economic outlook continues to improve. Inflation is decreasing and the balance of payments will be in approximate equilibrium in

1984, after recording a large deficit during the recession." Still, he concludes, "Italy's 1984–1985 recovery will be moderate and dampened by conflicting monetary and fiscal policies. The choice between more inflation and deflationary fiscal policies has been pushed into 1985, but can't be postponed indefinitely."

United Kingdom

"The prospect for the next two years is for growth to remain in the two to three percent range, for inflation to stabilize around five percent, and for the current account of the balance of payments to remain in moderate surplus."

OECD Economic Outlook

It is not only British travelers returning from the Continent who feel that Britain's economic performance compares most favorably with that of Germany. Barclays Bank commented this Summer that the United Kingdom used to be described disparagingly as "the sick man of Europe." These days, it would probably be fair "to describe the whole of Europe as a hospital ward, the United Kingdom being seen as one of the patients showing better recovery prospects; and that erstwhile most robust of athletes, West Germany, showing worrying signs of relative weakness."

The panel's assessment of Britain's near-term prospects was generally upbeat. One respondent listed the following favorable factors, telegram-style:

- "Despite the miners' strike, business growth cycle remains good at 2.2 percent for 1984, and 2.0 percent for next year.
- "Unemployment remains high, at 12.7 percent, but should decline as industrial production growth, led by export growth, climbs.
- "Plant and equipment spending to increase as 34 percent of firms are operating at full capacity (as against only 23 percent in previous survey).
- "Consumer prices now stabilized at 5.5 percent rate."

Similar positive indications are reported by another panelist: "Investment, while strong since the end of 1983, still has not recovered to its previous peaks, but rising orders and good profits have boosted business optimism. Improved cash flow and a short-term stimulus from changes in corporate taxes are also energizing investment plans. At the same time, exports have responded strongly to the renewed competitiveness of the currency and reviving economic activity elsewhere. These factors could prolong the British recovery into 1985."

Comments a third respondent: "The economy will remain on an expansionary path in 1984–1985. Although the coal miners' strike is causing an indeterminate loss of output and disruption to the British economy, other key sectors are tracking satisfactorily. Gross fixed investment and exports are taking over as the driving forces to the economy."

A cautionary note is injected by one panel member, who feels that the favorable outcome generally foreseen for next year could easily be altered by a number of events: "Most important is the impact from the current high levels of strike activity, including workers in such vital areas as mining and transportation. The impact of these strikes cannot be fully assessed until settlements are reached. Those settlements and the recent plunge of the pound are likely to add to domestic inflationary pressures."

A similar note is struck by another panel member: "Putting aside the consumer sector, the outlook for the British economy is unexciting. The coal miners' and dock workers' strikes have only served to open the government-labor rift a bit further. Granted, we do not envision a repeat of the chaotic 1970's, when labor unrest brought down a government and played havoc with British financial markets. But the U.K.'s inability to chip away at the 10 to 12-percent unemployment level presages low industrial productivity growth for the near future." The strikes, another respondent notes, "could also have negative repercussions on inflation as a result of a worsening trade balance and a weaker pound sterling." (The dock workers ended their strike in mid-September, without winning any major concessions.)

Other Countries

This section presents selected comments by panelists on ten additional countries. Projections for these (plus some other) countries are given in Table 2.

"In **Argentina**, the Alfonsin administration continues to try to reconcile austerity measures needed to meet the approval of the International Monetary Fund with measures considered necessary to stimulate the economy. Growth in real GDP is forecast at 2 percent for both 1984 and 1985. Inflation, currently running at an annual rate of almost 600 percent, is expected to average over 500 percent for the full year 1984, but slow to 300 percent in 1985."

"In **Australia**, the favorable influence of the agricultural recovery has run its course and further economic stimulus will now have to come from the consumer, from higher government expenditure, and from investment, especially residential construction. Real GNP is forecast to grow by 5 percent in 1984, slowing to 2 percent in 1985. Private-sector capital spending remains the outstanding area of weakness, reflecting the world economic and investment outlook, high cost structures, and lackluster penetration of markets in growth areas, particularly in the Pacific Basin. The inflation rate is showing a substantial drop this year, with 6.5 percent expected, compared with 10.1 percent in 1983. Part of that decline, however, reflects the removal of medical costs from the index. For 1985, the rate is expected to increase to 7.5 percent."

Table 2: Selected Projections of GNP and Price Changes, 1985, for Smaller Industrial and Major Developing Economies
(Annual rates, in percent)

	1985/1984			*1985/1984*	
	Real GNP	*Consumer Prices*		*Real GNP*	*Consumer Prices*
Australia	2.0	7.5	Argentina	1.0	365.0
	2.5	6.0		2.0	300.0
Austria	2.8	5.0	Brazil	0.0	100.0
	3.0	4.5		2.0	194.0
Belgium	1.5	6.0	Hong Kong	5.0	8.0
	2.0	6.0		6.5	11.0
Netherlands	2.0	4.0	Korea	6.5	5.0
	3.0	3.0		7.0	7.0
Spain	2.7	8.5	Mexico	1.0	60.0
	1.5	10.0		5.0	55.0
Sweden	2.5	5.5	Taiwan	6.5	6.5
	2.5	7.5		7.0	4.5
Switzerland	2.5	2.5	Venezuela	0.0	32.0
	2.5	3.8		1.5	18.0

"Recent developments in the **Brazilian** economy have led many economists to state that the domestic situation was improving and that the recessive trend could be reversed soon. Even the government is now projecting a positive 1 percent GDP performance for this year. However, the true economic situation may not be as good as seen by the government and those economists. High inflation and disappointing GDP performance, quite possibly at minus 2 percent this year and zero next year, will prevent purchasing power from recovering. Thus, the domestic economy has not yet recovered from previous losses and will continue depressed in both 1984 and 1985."

"**Hong Kong** has been happily caught up by the positive phase of the world business cycle. Since the United States is Hong Kong's major market and consumer goods are the leading export category, the territory has benefited mightily. Also, since trade lives on finance and transportation, Hong Kong, having few rivals in either of these services, has been triply blessed. In summary, the present economic situation and the near-term outlook have to be characterized as far more promising than anyone could have hoped. Beware of any forecasts for the late 1990's, however (when the territory will revert to China). They literally would not be worth the paper they are printed on."

"**Koreans** are smiling these days and understandably so, since they are enjoying their best economic performance since 1978. Looking ahead, two phrases sum up our outlook—further economic transition and trade liberalization. To date, Korea's recovery has been broadly based, spreading from the relatively small construction and domestic consumption sectors to heavier industry and exports. To avoid being labeled 'another Japan,' Korea is promoting import liberalization. We expect very selected progress in dismantling trade barriers—just sufficient to keep trading partners' concerns, mainly those of the United States, at bay. Korea's current-account deficit should not suffer as a consequence and, in 1985-1986, it could actually be in balance."

"The **Mexican** economy is on an improving path, but inflation is still higher than targeted. In the first quarter, controlled prices for electricity, petroleum and basic foods were hiked. While further increases in those prices are unlikely this year, inflation continues to put pressure on the peso and to encourage capital flight. Moderate growth in capital formation is expected to begin later this year in the public sector, and in the private sector in 1985."

"In the **Netherlands**, three consecutive years of economic decline have forced the government to awaken to the sad reality that it can no longer afford the expensive social programs it has been implementing for years. Plans announced this Spring indicated a reduction in the budget deficit to 10.7 percent of GNP this year, from 11.5 percent in 1983. If the world expansion goes as well as we expect, the Dutch can look forward to several years of respectable economic growth. Rising world demand will spur further increases in exports. Private investment will continue to grow as the business sector sees profit margins increasing. Consumption will pick up eventually as the country's fiscal position improves."

"In the midst of a brighter economic picture, **Sweden** is beginning to feel a disquieting sense of déjà vu. In the late 1970's, the country was enjoying a strong economy, only to be knocked out by a surge in inflation. Economic indicators are pointed to a repeat performance for late

1984–1985. With exports still rising and a very low unemployment rate (2 to 3 percent), Sweden is suffering from a shortage of skilled labor to keep the growth pump primed. Result: A steady dose of wage inflation and a loss in international competitiveness. Further government restraint can, therefore, be expected in the medium term. Moreover, changes in the international economic mood become critical to the Swedish business outlook."

"Economic growth is accelerating in **Taiwan**, as exports and corporate profits are booming. Real GNP grew at a 12 percent annual rate in the first quarter, compared to a 7.1 percent rate for all of 1983. Growth rates of 9.1 and 8.8 are anticipated for calendar years 1984 and 1985. Government spending was cut for the first time in 30 years in the fiscal year ending June, 1984. The budget for the 1984–1985 fiscal year calls for an 11 percent spending increase."

"Domestic demand in **Venezuela** has been largely flat this year to date, owing to delays and swings in policy implementation. The exchange rate has fluctuated widely because of the multitiered system and speculation. Recent policy moves were a little more enlightened—an increase in the maximum interest rate should stimulate more lending. Public-sector interest arrearages have been reduced significantly since March, but private-sector arrearages remain in the $800–$1,000 million range. Growth is expected to improve slightly from minus 1 percent this year to plus 1 percent in 1985."

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number 170

The Impact of Technological Change on Corporate and R & D Management

A Survey

by James K. Brown

The Conference Board

THE RELATIONSHIP between technology and a company's competitive strength is gaining ever-wider recognition. "Technological innovation will dictate competitive advantage and disadvantage." This statement by a senior executive of a U.S. construction materials manufacturer is typical of many elicited in the course of recent Conference Board programs concerned with technology and its management. Similarly, a recent survey report of European chief executives found that "...technology represents an opportunity, a threat, a tool--but not an end in itself. Yet its impact on competitive position—at both corporate and national levels—can be so profound that it must be thoroughly understood and managed, if unacceptable risks are not to be run."[1]

What is perhaps less clearly perceived is how technological change has affected and will affect the *management* of the company as a whole and, more specifically, its research and development resources. It is this relationship that the present survey, reflecting the experiences and expectations of 242 executives in 15 highly industrialized nations, addresses.

The principal findings are that, in the next one to three years, developments in the technological environment will have broad but uneven effects on management in general and the research and development function in particular, and that in the realm of R&D, these effects will be greater than they were in the year before the survey was conducted (see the italicized passages on page 8)[2].

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[1] Booz, Allen & Hamilton Inc., "Management and Technology: A Survey of European Chief Executives," 1984, p. 1.

[2] That environmental developments in the near term will have greater consequences for management than these developments have had in the recent past is a central point of a Conference Board study on the regulation of international data transmission across national borders. See James R. Basche, Jr., *Regulating International Data Transmission: The Impact on Managing International Business.* The Conference Board, Report No. 852, 1984.

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The Survey Participants

Conducted in the early months in 1984, the survey drew responses from 242 senior executives—the great majority of them in charge of their companies' technological programs—of leading firms in the United States, Europe and Japan. Most of these firms have annual revenues or assets in the range of U.S. $100 million to $10 billion; 22 are larger and four are smaller. The participating companies are further described in the table below.

Characteristics of Participating Companies[1]

	Number of Companies with Headquarters		
Dominant Function	*in U.S.A.*	*outside U.S.A.[2]*	*Total*
Research, engineering, manufacturing	91	20	111
Marketing	25	3	28
Utilities	19	1	20
Finance	3	5	8
Transportation	5	1	6
Other services	6	2	8
Several functions	40	10	50
Totals	189	42	231

• • • • • • •

Diversity and Complexity	
Set of related businesses	155
Set of unrelated businesses	36
A single business	44
Total	235

[1] None of the totals equals 242 because of incomplete response to the questions that generated these data.

[2] One Japanese company; the others are European.

Significant Developments in the Technological Environment

Table 1 (see page 4) presents data on the developments in the technological environment that respondents chose as likely to affect how their companies will be managed in the next one to three years. The "first" and "second" rankings determined the order of the table, although process production technology had fewer mentions overall than R&D, administration, and mechanical production technology.

The salient findings are:

- Perhaps not surprisingly, in view of the composition of the survey participants, technology used in R&D management has more "most important" and "second most important" votes than technology used in any other field. From the same perspective, technology used in process production is next.
- In terms of total mentions, on the other hand, technology used in administration leads the list, with technology used in R&D a close second; well behind are technology used in mechanical production and in process production. Indeed, except for distribution, none of the fields of application of technology has the same rank in number of mentions and in number of times it is judged as first or second in importance. The full comparison:

Field of Application	Frequency of Mention	Frequency of Mention as First or Second in Importance
Administration	1	3
Research & Development	2	1
Mechanical Production	3	4
Process Production	4	2
Marketing	5	6
Distribution	7	7
Other	6	5

Table No. 1: Major Technological Developments Expected to Affect Company Management in the Next One to Three Years

Technology Used In	*Ranking by Relative Importance Number of Mentions* Top Range (1st or 2nd)	Middle Range (3rd or 4th)	Low Range (5th, 6th or 7th)	Total Mentions
Research and Development (e.g., computer-aided design, instrumentation)	134	62	9	205
Process Production (e.g., biotechnology, conversion of older industries from batch to process production)	95	44	13	152
Administration (e.g., word processing, data processing, material requirements, planning, documentation)	87	90	31	208
Mechanical Production (e.g., machining, forming, robotics, testing)	86	49	20	155
Marketing (e.g., telemarketing, electronic "yellow pages," field servicing)	36	61	30	127
Distribution (e.g., warehousing, transportation)	22	53	33	108
Other functions	28	4	2	34

- When the "upper" and "middle" ranges are combined (ranks "1" to "4"), there is again a slightly different order. Since these functions were described on a questionnaire and the respondents were asked to rank them *all,* the best summary statement may be that the first four items listed in the tabulation and in Table 1 are judged to be more likely to have a significant impact in the short-term future.

Chi-square tests were run on responses to this and subsequent questions to glean clues as to meaningful differences between U.S. and non-U.S. companies and among companies grouped by diversity and complexity.[3] At the .05 level of significance:

Area of Technological Development	Sample Results Variable Found to Have Significant Difference	Companies Expecting to Have Managing Affected to a Greater Degree	Companies Expecting to Have Managing Affected to a Lesser Degree
R&D activities	Headquarters location	U.S.	Non-U.S.
Mechanical production	Diversity and complexity	Unrelated businesses	Single businesses
Process production	Diversity and complexity	——	Single businesses
Distribution	Diversity and complexity	Single businesses	Unrelated businesses
Administration	Diversity and complexity	Single businesses	Single businesses

---

[3] A chi-square test entails comparing expected or computed frequencies with observed or actual frequencies of two variables to see whether discrepancies between expected and observed frequencies are greater than might be expected by chance.

Perspectives

A number of executives offered perspectives on developments in technology in general and its application or emphasis in their own companies in particular. Several pointed out that their firms are already making extensive use of technology in one or another function (R&D, production, marketing, etc.). Others emphasized the consequences of technology for marketing or for their customers. For instance:

"Process-production technology is primarily a marketing opportunity, not an in-house one."

—*A U.S. industrial products manufacturer*

"We see technological developments in the *use* of many of our products."

—*A Dutch manufacturer*

"Impact of technology on the businesses we serve, which can affect products we sell them."

—*A U.S. chemical and drug manufacturer*

"Technology leading to advanced performance of the product or products, with new capabilities and potentially new markets."

—A U.S. aerospace manufacturer

"We expect more direct contact with customers."

—A U.S. chemical company

"In the retail portion of our business, the development of electronic scanning systems will lead to significant change."

—A Danish manufacturer and distributor

"Technology to develop new products, which could create new markets."

—A Japanese steel manufacturer

"R&D must develop products that are based on technology exhibiting a customer benefit."

—A U.S. building material manufacturer

For still others, materials and products stood at the forefront of concern:

"Reduction in commodity products and development and increasing activity in special chemicals."

—A U.S. petrochemical company

"New or improved materials in their applications (i.e., ceramics in engines, engineering plastics, conductive polymers) requiring substantially different resource requirements and R&D approaches."

—A U.S. industrial equipment manufacturer

"We attach importance to scientific developments in catalysis material."

—A U.S. petroleum refiner

Another theme in these obiter dicta was the integrated or interactive effects of new technology:

"The interaction of design and manufacturing technology—the integration of CAD and CAM."

—A U.S. farm equipment manufacturer

"Integration of several of these areas (R&D, production, etc.), in plants fully automated from initial design to inspection and field service."

—A diversified U.S. manufacturer

"Joint R&D between two or more companies, either in different geographical areas or at different levels in the chain."

—A U.S. chemical manufacturer

Then there were variegated comments on the emphasis of technological programs sponsored by individual companies:

"Speed and accuracy most important in R&D-related technology."

—A U.S. electronics and communications company

"R&D technology is critical to improve design and management of production."

—A U.S. aerospace manufacturer

"In mechanical production, quality is the main objective."

—A U.S. electronics and communications company

"Application of mechanical production necessary for increased productivity and less reliance on skilled personnel."

—A U.S. aerospace manufacturer

"In process production technology, there are two concepts: new types of industry and revitalization of older plants. Both would be important."

—A diversified U.S. manufacturer

"We have undertaken a program of evaluating process production technology in our pilot plants, and then to institute a program to give the company a leading edge in technology."

—A U.S. drug company

"Much effort is needed to update existing power plants to 1980's technology."

—A U.S. utility

"The use of technology in administration is a result of management commitment to improve productivity."

—A U.S. industrial products manufacturer

"An important thrust is in environmental matters: the control and disposal of toxic substances and hazardous wastes."

—A U.S. paint manufacturer

One executive stressed the indisputably vital role of corporate leadership with respect to the adoption of new technology.[4] Noting that his company would have a new chief executive officer in 1985, he said that "his view of high technology" will prevail. And the respondent added: "If we are acquired by another company, we shall have another new view of high technology."

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[4] This point was stressed by contributions to two recent Conference Board reports: James K. Brown (ed.), *Research and Development: Key Issues for Management*, Report 842, 1983; and James K. Brown (ed.), *Manufacturing: New Concepts and New Technology to Meet New Competition*, Report 844, 1984.

Not all the survey participants are believers in the precept that technology will exert a strong influence on how companies conduct, or will conduct, their affairs. Thus, a diversified U.S. consumer products manufacturer observed: "I do not see technology affecting *how* we manage the business in the next three years."

Specific Applications

In terms of specific applications, some of the surveyed executives gave examples other than those given in Table 1.

In R&D: expansion of data sources for new ideas; automation of laboratory experimentation and data manipulation; color matching by computer.

In process production: development of new combustion processes (e.g., pressurized fluidized beds); environmental clean-up processes; heat and power conservation; computer-controlled chemical plants; heavy oil processing; new polymers; new catalysts.

In administration: electronic mail—internal, external, international; increased use of personal computers (enabling "a major share of professional staff to use PC terminals from home," a British executive opines).

In mechanical production: testing; automatic defect rejection; computer networking data-base management; group technology.

One Impact of Technology on the Judiciary

"There is such an abundance of precedents in so many areas, so many hundreds of thousands of reported cases, all retrievable through computerized research tools, that a great many decisions at every level of the judicial system are, in a sense, chosen rather than determined."

—Judge Richard A. Posner
U.S. Court of Appeals
for the Seventh Circuit;
cited in Betty Bock and others,
The Future of Antitrust
Conference Board Research
Bulletin No. 163, 1984.

In marketing: electronic medical education; explosion in use of credit or debit cards in Europe; marketing and customer information management.

In distribution: working capital (particularly inventory) management; automation of order preparation and selection; local control of an electrical utility's distribution facilities.

Other applications: power generation, transmission and distribution; exploration for oil and gas; scheduling; inventory control; purchasing.

Effects of Changes in the Technological Environment on R&D Management

Table 2 shows the relative strategic importance attributed by survey participants to the several elements of R&D management likely to be affected by changes in the technological environment in the next one to three years. As can be seen, changes in planning procedures and organizational linkages lead the list, with top management's efforts to spur innovation a respectable second.

In contemplating planning-organizational and human-resources areas of change, it is useful to look ahead to Table 3. Note that some of the elements of changes in planning procedures and organizational linkages center on people—for instance, greater involvement of technology managers in setting corporate direction and increasing involvement of R&D people in corporate planning. Thus broadened in scope, the human side of R&D management may be more significant than the barebones data in Table 2 indicate. Many contributors to recent Conference Board publications on R&D management and the adaptation of modern manufacturing technology underscored the importance of people issues. (See footnote 4, page 5.)

In this ranking of areas of change by strategic importance, there was no meaningful difference among companies grouped by diversity and complexity. As for headquarters location, U.S.-based companies were less likely than non-U.S. companies to choose as more important (first or second rank) the general issue of "human resources aspects" of R&D management.

Changes in Planning Procedures and Organizational Linkages

Table 3 depicts the contributors' experiences in the last year, and their expectations for the next one to three years, with respect to the impact of changes in the technological environment on various aspects of planning procedure and organizational linkages. The salient findings:

- Although changes in planning procedures and organization linkages received more first and second rankings in terms of strategic importance than any other sector of change (Table 2), no specific planning-organizational

Table No. 2: Relative Strategic Importance of R&D Management Changes

	Ranking by Relative Importance Number of Mentions		
Area of Change	*Top Range (1st or 2nd)*	*Middle Range (3rd or 4th)*	*Low Range (5th or 6th)*
Planning procedures and organization linkages	148	61	28
Top management's efforts to spur innovation	131	66	39
Internal aspects of R&D management	74	106	51
Human resource aspects of R&D management	73	99	59
Financing of R&D	43	86	99
External aspects of R&D management	16	53	157

Table No. 3: Impact of Technological Change on Planning Procedures and Organizational Linkages (Responses in Percent)

	Strategic Importance of Change						
	In past 12 months		*In next 1-3 years*		*Shifts in Impact*		
Area of Change	*Major*	*Minor*	*Major*	*Minor*	*Up*	*Down*	*No Shift*
Greater involvement of technology managers in setting corporate direction	31	56	59	36	38	3	59
Increasing influence of technology on corporate strategy	41	50	68	29	33	2	65
Increasing formal technological forecasting	9	51	24	58	35	1	64
Improving the linkage of technology to other business functions	35	53	61	35	35	3	62
Raising the stature of technology management with respect to other business functions	18	58	39	48	32	3	65
Increasing involvement of R&D people in the corporate planning process	24	56	46	43	32	2	66
Increased involvement of the CEO in the technological planning process	24	50	35	51	24	2	74

Other planning-administration linkage changes volunteered by the respondents were: broader analysis and application of technological strengths; fitting technology to serve the markets; launching a formal research-planning group; marketing involvement in R&D planning and in strategic planning; technology assessment and monitoring; placing former R&D personnel into operating positions to enhance technology transfer from labs to practical application; and MBO programs, automatic inventory control, quality assurance management.

change triggered a substantial strategic reaction in more than 41 percent of the companies in the 12 months before the survey was conducted.

- A majority of the respondents expect three changes to have major strategic importance in the next one to three years: increasing influence of technology on corporate strategy (68 percent); improving the linkage of technology to other business functions (61 percent); and greater involvement of technology managers in setting corporate direction (59 percent).

- *For each aspect of planning-organization, there was a higher percentage of "major" votes for the next one to three years than for the last twelve months. This holds true for every item in the remaining tables, with a single exception (second item, Table 7).*

- "No shift in emphasis" was the predominant outlook, accounting for over 50 percent of the judgments for each activity listed in Tables 3 to 8. *But where there were shifts in emphasis (counting up or down all changes between the past year and the next one to three years) they were overwhelmingly in the upward direction (e.g., minor to major, none to minor, none to major) in this and subsequent tables.* (Again, the sole exception is the second activity in Table 7.) In fact, downward shifts in emphasis did not exceed 11 percent of responses in any table, and were more typically less than 5 percent.

Technology managers in U.S. companies were more likely than their counterparts in non-U.S. companies to have become more involved in setting corporate direction in the year before the survey was conducted. Expectations for the next one to three years showed these statistically significant differences among groups of companies:[5]

		Sample Results	
Area of Change	Variables Found to Have Significant Difference	Companies More Likely to Make Changes	Companies Less Likely to Make Changes
Greater involvement of technology managers in setting corporate direction	Headquarters location	U.S.	Non-U.S.
Increasing formal technological forecasting	Headquarters location	U.S.	Non-U.S.
Raising stature of technology management with respect to other business functions	Headquarters location	U.S.	Non-U.S.
Increased involvement of CEO in the technological planning process	Headquarters location	U.S.	Non-U.S.

[5] .05 level or lower, chi-square test.

Top Management's Efforts to Spur Innovation

Table 4 summarizes results and expectations regarding the influence of technological change on top management's efforts to spur innovation. In the previous year, such change did not have major strategic effects on any of the listed efforts in as many as a third of the companies, nor is it anticipated to do so in the next one to three years in as many as half the companies ("increased emphasis on internal growth" was judged "major" by 48 percent).

In the array of firms by diversity and complexity, single-business companies were *less* likely to have bestowed greater recognition on, and made efforts to motivate, internal entrepreneurs, in the past year; and unrelated-business companies (conglomerates) were *more* likely to have sought to capitalize on governmental programs to spur innovation, and to do so in the next one to three years.

Financing R&D

Technological change has not had, nor is it likely to have, an influence of major strategic importance on R&D financing in most firms represented in the survey, as Table 5 (see page 10) indicates. The element of financing on which it has, and is expected to have, a significant impact in the largest number of companies is absolute increases for capital equipment used by R&D personnel, followed by increases in *relative* R&D expenditures.

The Human Resources Side of R&D Management

In the next one to three years a majority of the respondents foresee that technological change will result in changes of major strategic importance in two closely related aspects of human-resources management: efforts to improve individual performance and upgrading the quality of the R&D staff (Table 6, page 11). When the companies were

(text continued on page 12)

Table No. 4: Impact of Technological Change on Top Management Efforts to Spur Innovation (Responses in Percent)

	Strategic Importance of Change						
	In past 12 months		*In next 1-3 years*		*Shifts in Impact*		
Area of Change	*Major*	*Minor*	*Major*	*Minor*	*Up*	*Down*	*No Shift*
Greater recognition and motivation of internal entrepreneurs	22	53	44	46	38	2	60
Simplification of traditional procedures and practices	16	55	30	55	30	4	66
Increased emphasis on internal growth	30	48	48	39	29	4	67
More efforts to capitalize on governmental programs to spur innovation[1]	11	36	17	38	16	2	82

[1] See box on page 10 for specific programs mentioned.

Other Management Efforts to Spur Innovation

Survey participants reported a plethora of efforts their companies have undertaken, or will undertake, to spur innovation (other than those suggested to them on the questionnaire and summarized in Table 4) with internal thrusts much more frequently mentioned than external thrusts. Taken as whole, these initiatives may serve as a useful check list.

Internal Thrusts

Organizational changes: Formation of high-level technology or innovation committees, institution of a "dedicated diversification group," decentralization of decision making, better integration of research into other functions or units.

Motivational efforts: More recognition of and rewards for innovators, enhanced teamwork among researchers, gainsharing (programs like the Scanlan Plan that link extra compensation to productivity improvements).

Management directional efforts: Better administration, better guidance of the innovation process, use of deadlines, employment of consultants, seeking internal entrepreneurs, new practices aimed at doing more with less, changed (presumably improved) management style.

Investment: Expansion of laboratory facilities, longer-term funding, provision of seed money.

Educational initiatives: Making technical innovators more aware of business and customer requirements, instilling greater understanding of technology throughout the organization.

External Thrusts

Obtaining technology developed by others—by acquisitions, licensings, venture-capital programs.

Participating (more fully) in collaborative efforts: joint ventures, industrywide cooperative undertakings, university-industry programs.

* * * *

Some of these changes have been cited in the earlier discussion of planning procedures and organizational linkages, and others are in the examination of R&D financing and of the internal human resource and external aspects of R&D management. The moral seems to be that R&D management is more a rich and complex tapestry, characterized by extensive interplay among its elements, than a collection of discrete, neatly compartmentalized tasks.

About Government Programs

Some survey contributors commented on government programs to spur innovations. Among them were spokesmen of firms already involved in such programs. "Cooperation with government to launch new business has always been a strength of our corporation," noted the representative of a chemical company. And an executive of an electronics firm said: "A major segment of the corporation participates in government R&D." In effect, these respondents indicated that their firms would continue, perhaps enlarge, such involvement.

Other participants referred to programs, both specific and general, in which their companies have been and/or would be participating: Allowance for Funds During Construction (applicable to U.S. utilities), ESPRIT (European Strategic Program of Research in Information Technology), development contracts and credits, R&D tax incentives, emission control innovations (cited by a public utility), product development for the Department of Defense, the Ben Franklin Program (sponsored by the Commonwealth of Pennsylvania), and the programs of the National Aeronautics and Space Administration (e.g., communication satellites), the Department of Energy, and the Synthetic Fuels Corporation. Some of these programs, of course, have a financial rather than a technological thrust.

One major U.S.-headquartered multinational corporation appeared to be a reluctant dragon. It will participate in government programs "maybe after three years." A Finnish executive observed that "new governmental programs have not been started" in that country.

Table No. 5: Impact of Technological Change on the Financing of R&D (Responses in Percent)

	Strategic Importance of Change						
	In past 12 months		*In next 1-3 years*		*Shifts in Impact*		
Area of Change	*Major*	*Minor*	*Major*	*Minor*	*Up*	*Down*	*No Shift*
Increases in R&D expenditures related to R&D tax incentives	8	49	12	54	16	3	81
Increases in R&D expenditures relative to other expenditures or fixed investments	20	47	28	50	23	5	72
Absolute increases in capital equipment for R&D people	28	48	40	45	26	6	68
Participation in joint research ventures or partnerships	14	46	26	52	29	2	69

Other changes in funding R&D mentioned were: Creating limited R&D partnerships (cited by three U.S. companies); obtaining funds from venture-capital firms or establishing such firms; licensing of company technology to others; obtaining government grants; doing contract R&D work for government agencies and private companies; crediting the R&D unit with some of the funds flowing from commercialization of its work; providing centralized pools of R&D funds (instead of having each operating unit responsible for R&D expenditures); and sharing R&D expenditures with customers.

Changes in Project-Selection and Evaluation Techniques

Asked to specify changes in project-selection and evaluation techniques flowing from changes in the technological environment, the cooperating executives offered a wide-ranging list that can be grouped in four categories:

Shifts in criteria for evaluation: more emphasis on projects with longer-term payouts; on basic R&D; on new ventures; on projects with better ROI; and on manufacturing technology.

Introduction of new and different procedures: consideration of a greater number of projects; opportunity analysis; adoption of a technical request system; greater use of quantitative techniques; improved procedures for assessing probability of success; better profit-potential forecasting; fuller use of computerized program and project planning and evaluation; different screening and review procedures (both more formal and less formal procedures were mentioned); major changes in procurement methods; portfolio analysis; a larger role for the R&D unit or the senior R&D executive in the project-selection process; more opportunity for the R&D unit to initiate projects; creation of a new research-planning group with responsibilities that include evaluation.

More involvement of others in the organization: mentioned were corporate management; other entities—divisions, operating companies, departments, marketing, corporate planning, the parent company, nontechnical management, business management, peer groups.

More focus on strategy and the market place including, according to one respondent, more emphasis on *new* markets.

Table No. 6: Impact of Technological Change on the Human Resources Aspects of R&D Management (Responses in Percent)

	Strategic Importance of Change						
	In past 12 months		*In next 1-3 years*		*Shifts in Impact*		
Area of Change	*Major*	*Minor*	*Major*	*Minor*	*Up*	*Down*	*No Shift*
Enlargement of the R&D Staff	17	39	19	55	31	11	58
Efforts to improve individual R&D performance	35	54	59	35	31	3	66
Efforts to measure R&D performance more accurately	15	61	35	54	30	1	69
Intensification of training and retraining of R&D employees and/or supervisors	17	56	34	48	26	2	72
Upgrading quality of the R&D staff	33	51	51	39	24	4	72

Other reported externally-oriented changes included: introduction or expansion of efforts to track technologies developed and used outside the company; more intensive monitoring of competitors' R&D programs; closer linkages with customer/suppliers and, where appropriate, companies in the same field; more aggressive licensing ("both ways," said a U.S. manufacturing company executive); deeper involvement in industry-wide programs; and participation in national boards and commissions concerned with R&D.

(text continued from page 8)

grouped by diversity and complexity, significant differences emerged. Single business companies were less likely to have made changes in the past year, and to make changes the next one to three years, in (1) intensification of training and retraining, and (2) upgrading the quality of the R&D staff.

Other Internal Aspects of R&D Management

Neither retrospectively nor prospectively do as many as two-fifths of the companies represented in the survey find technological change altering other aspects of internal R&D management in a major way (see Table 7). The aspect of internal management that garnered the most "major" judgments for the recent past and the future—changes in project selection and evaluation techniques—also elicited more written comments (box, page 11) than any other issue raised in the survey; over 20 percent of the respondents contributed examples of such techniques.

External Aspects of R&D Management

As Table 8 shows, external elements of R&D management have been substantially altered by technological change in comparatively few of the participating companies. For the future, about a third of the firms expect major changes in linkages to universities. (These linkages, and the formation of advisory committees, were also mentioned in connection with other areas of R&D management.)

One of the changes shown at the bottom of Table 8 is more intensive monitoring of competitors' R&D programs. Like the other changes listed there, this one was volunteered by only a handful of respondents, but they considered it a "major" issue. In view of the increasing and recently well-publicized realization of technologically oriented U.S. companies that they need to do a far better job of informing themselves about the progress of their Japanese competitors, one wonders whether this factor may prove to be more important than is now anticipated.

Table No. 7: Impact of Technological Change on Other Internal Aspects of R&D Management (Responses in Percent)

	Strategic Importance of Change						
	In past 12 months		*In next 1-3 years*		*Shifts in Impact*		
Area of Change	*Major*	*Minor*	*Major*	*Minor*	*Up*	*Down*	*No Shift*
Increases in basic and/or applied research compared with product and process development	11	41	22	44	26	6	68
Decreases in basic and/or applied research compared with product and process development	6	29	6	27	5	7	88
Changes in project selection and evaluation techniques	22	50	36	44	28	7	65

Other reported internal R&D management changes in the surveyed firms were: creation of vice president-technology position (two mentions); creation of technical information coordinator to improve application of significant R&D done by industry groups and U.S. government agencies; infusion of market considerations and expertise into R&D planning and evaluation (three mentions); more emphasis on university input; greater use of corporate committees; emphasis on identifying most promising projects and focusing more intently on the chosen few; consolidation of two divisional research organizations; emphasis on newer technology; the bestowal of more freedom to innovate on lower levels of the company; integration of planning for R&D and business planning; and establishment of corporate research-project identification procedures.

Table No. 8: Impact of Technological Change on External Aspects of R&D Management (Responses in Percent)

	Strategic Importance of Change						
	In past 12 months		*In next 1-3 years*		*Shifts in Impact*		
Area of Change	*Major*	*Minor*	*Major*	*Minor*	*Up*	*Down*	*No Shift*
Increases in R&D effort to meet external pressures (e.g., government, consumerism)	17	51	19	54	11	3	86
Formation of an outside science and technology advisory committee to guide R&D	7	18	8	29	17	4	79
Closer company linkages to universities	20	62	34	55	25	4	71

Other reported externally-oriented changes included: introduction or expansion of efforts to track technologies developed and used outside the company; more intensive monitoring of competitors' R&D programs; closer linkages with customer/suppliers and, where appropriate, companies in the same field; more aggressive licensing ("both ways," said a U.S. manufacturing company executive); deeper involvement in industry-wide programs; and participation in national boards and commissions concerned with R&D.

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Labor Outlook 1985

by Audrey Freedman et al

The Conference Board

THE CONFERENCE BOARD'S 1985 LABOR OUTLOOK PANEL

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The Conference Board's annual session on the labor outlook took place on November 8, 1984. Panel members discussed the current economic situation, compensation trends, human resource developments, labor relations, and political events. This process provided the predictions for 1985. The individual views quoted were submitted by the participants before the discussion.

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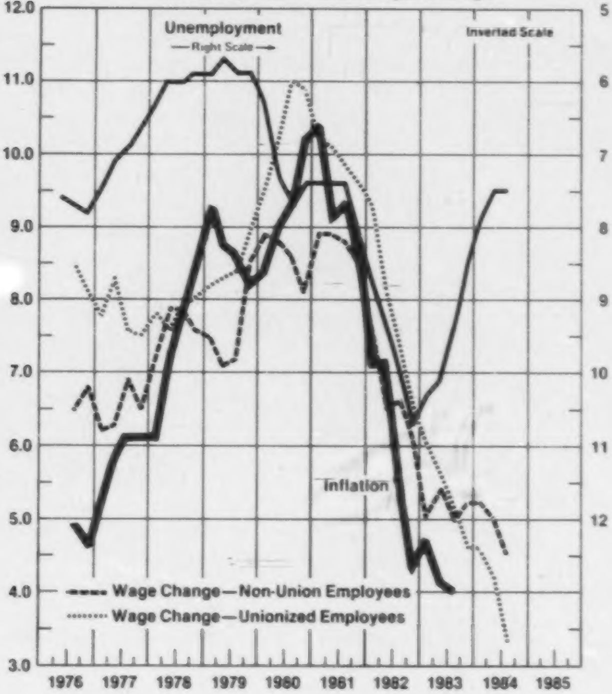
LABOR OUTLOOK 1985

The Conference Board's Labor Outlook panel foresees a year of placidity in 1985 with a small decline in unemployment, small increases in wage and price inflation, and less growth in the economy as the recovery tops out. Characteristically sensitive to portents of trouble, this year the panel found none. This does not mean that our forecasting session was ebullient; placidity would best describe the overall mood. The strength of the recovery has exceeded the panel's expectations for two years; wage inflation has moderated even though unemployment fell sharply in 1983 and 1984. Now, the panel says, a full year of plateau will ensue.

Chart 1

Unemployment[1], and Wage Change[2]



Quarterly civilian unemployment rate, seasonally adjusted

Rates of Wage and Salary Change in the Employment Cost Index for Union and Non-Unionized Employees, for 12 months ending in the quarter indicated

Labor-market recovery has been strong in 1983 and 1984, with none of the usual effect on wages, so far. (See Chart 1.) In the past year, because jobs have been available, the civilian labor force has grown by over two million—at a faster-than-normal (1.9 percent) rate. In the same period, civilians *employed* have increased by 3.6 million—a 3.5-percent rate. Yet wage inflation has not been ignited by this rapid tightening of the labor market, perhaps because the overall unemployment rate, at 7.3 percent, is still high by historical standards for a recovery.

The panel expects the unemployment rate to stay on its current level throughout 1985. (See Table 1.) In other words, no further improvement. With labor-force growth on its trend line of between one-and-a-half and two million, the panel's unemployment prediction means that it expects job creation to absorb that growth—but not to exceed it. So, in 1985, total employment will increase at about the same rate as the labor force, that is, much more slowly than it has in the two recovery years the economy has enjoyed up to now.

Two panel members suggested a slight downturn in 1985: One pinpointed the first quarter; one said "after mid-year." All joined in the discussion with some evidence of business softening in their markets. A hypothetical decline of the dollar was introduced, and rejected. The panel clearly does not foresee recession during 1985.

Inflation? Not Now

Wage increases have been sharply moderated by the recessions of the early 1980's, and they do not seem to have been affected by the recovery. In the second year of strong recovery, average hourly earnings for production and nonsupervisory workers on private payrolls have increased 2.9

Table 1: Forecasts for 1985 by The Conference Board's Labor Outlook Panel

	Median (Percent)	*Range (Percentages)*
Overall increase in average hourly earnings, January, 1985 through December, 1985	3.5	2.5 to 5.0
First-year wage and benefit increases in major union contracts	4.0	3.0 to 5.5
Increase in labor costs per unit of output in manufacturing	2.5	1.5 to 4.1
Rate of inflation (average increase in Consumer Price Index)	5.0	4.0 to 5.0
Unemployment average during 1985	7.2	6.8 to 7.7
First quarter	7.2	6.8 to 7.6
Second quarter	7.3	6.7 to 7.5
Third quarter	7.3	6.7 to 8.0
Fourth quarter	7.2	6.9 to 8.0

percent (October, 1983 to October, 1984). The panel predicts that they will rise 3.5 percent during 1985. This is clearly no portent of a wage-price spiral. Confirmation of wage moderation appears in the panel's prediction of wage and benefit increases in union contracts to be negotiated next year: 4 percent. Last year, the panel identified competitive pressures on employers as the source of continuing moderation in wage settlements and among nonunion employees. Competition developing from deregulation is continuing, if not increasing. Competition from imports is increasing because of the strength of the dollar. As a result, strong employment growth has not affected compensation.

The modest growth of compensation, more than offset by productivity increases normal to a recovery, has brought stable unit-labor costs in manufacturing, and only modestly increasing unit-labor costs in the nonfarm business sector. Preliminary data show unit-labor costs rose 0.2 percent in manufacturing and 2.0 percent in nonfarm businesses in the year ending with the third quarter of 1984. The panel predicts rising unit-labor costs of 2.5 percent for manufacturing in 1985. This, combined with their wage predictions, suggests that productivity advances of 3 and 4 percent in manufacturing overall will fall back to 1 and 2 percent in the plateau economy of 1985.

Competition, especially from abroad, and the cost pressures it produces, have postponed any inflationary surge in this now middle-aged recovery. The panel expects some increase here, to 5 percent, in 1985. (The rate of increase of the Consumer Price Index in the third quarter of 1984 for all urban consumers, seasonally adjusted, was 4.5 percent.)

The panel functions as a "scout of the future," raising questions (and consciousness) about possible turning points in the economy that affect human resources. In general, there was no turning point foreseen in 1985. The possibility of a long period of stability—much like the mid 1960's—was discussed. They see such stability for the year ahead. Scouting for other problems, the panel discussed labor supplies of technically trained employees—and found some signs of difficulty; immigration—and expected controls to be legislated; politics—and found increased lobbying might succeed in raising protection against competition, even during an Administration inclined toward a free-market ideology. These and other details of the discussion are reported below.

The 1985 Economy and Labor Market

The panel saw no signs of recession in 1985, nor of volatility, but did interpret their current business experiences to foreshadow a reduction in growth from current levels for next year. Earl Royse suggested:

> "The economy appears to be cooling from its very rapid rate of increase earlier this year. This, in itself, is helping to control price inflation; but undoubtedly the strongest single influence is our robust dollar. This foreign-exchange influence is significantly moderating price increases of goods. However, prices in the service sector, representing a full one-half of the CPI, surged at a 7.2% rate in the third quarter. We can see what would happen to the overall price level if this trend continued in the service sector and the dollar started to slip.
>
> "For the short term, however, we see continued price stability and a low rate of inflation, and level—or sinking—interest rates. That would foreshadow a further drop in the unemployment rate in the current quarter, but this might be no more than one-tenth or two-tenths of a point.

EARL C. ROYSE
Vice President-Human Resources
Saga Corporation
Menlo Park, California

> "In 1985, much depends on whether interest rates continue to decline as they appear to be doing—or level off, or pick up again as the year progresses. More than one analyst has forecast the latter scenario. High interest rates have already apparently begun to take their toll on several major sectors of demand in the economy. In the third quarter, new orders in general construction contracts, nondefense capital goods orders, were down. All of this should translate into a decline in the demand for labor sometime during 1985. We might thus see the unemployment rate creeping back up to about 7.5 percent. For the year, however, the average rate could be lower, depending upon the accuracy of our 1984 fourth-quarter estimate and the timing of the slowdown (perhaps only a mini-slowdown) in 1985."

Jackie Presser saw signs of a dip at the beginning of the year, followed by an extended growth period:

> "The 1985 labor market will slow at the beginning of the year following the holidays and will not immediately return to expansion. Even though current statistics show a reduction in economic expansion in the second half of 1984 and indicate continued slow growth for the first quarter of 1985, a new recession is not in the offing. The pace of job creation will accelerate as the higher rates of investment, which business surveys indicate are in the cards for 1985, result in completed new plant and equipment. However, the rate of growth will still be slower than the rapid expansion of 1984 and, consequently, will make sustained economic expansion more probable and manageable. Unemployment is likely to remain even or rise early in the year, then fall to near 7 percent by year's end.
>
> "The job-creating ability of the U.S. industrial economy has shown strength that our European allies greatly envy. Service-sector employment has grown, even during recessions. As business expands capacity, new industrial job opportunities open up and fuel further expansion of the service sector.

JACKIE PRESSER
President
International Brotherhood of
Teamsters, Chauffeurs,
Warehousemen and
Helpers of America
Washington, D.C.

> "The response the labor market makes to economic expansion will be the traditional one. As the pool of unemployed jobseekers shrinks and job opportunities expand, the market-imposed floor on the minimum wage necessary to keep employees from seeking better jobs goes up. A couple of new twists will be added to the story this time, however. First of all, in the industrial sector the impact will be largely felt in the South and West. In the service sector, with segments and companies becoming more highly capitalized and increasingly competitive on a national scale, the additional pressures of a shrinking pool of jobseekers will force many firms to focus more on long-term retention of employees. The opportunity exists for employees in the service sector to enjoy the effects of the rising wage floor to an unprecedented degree."

The group did not avoid discussing the possibility that the "plateau of 1985" was the edge of a cliff. Ted Marston raised the issue this way:

> "I don't see a great deal of change in the labor market from 1984 to 1985. But there will be a continuation of the downsizing that took place in 1982 and 1983. Most of the heavy manufacturing companies still have too many people who are underutilized. The unemployment rate will not decline more in 1985. In fact, our planning is for a downturn in the economy starting in the second half."

The possibility that this is an economywide phenomenon was discussed, but rejected by the group. The farthest any would go was David Lewin's contingent description:

> "An important part of the forecast of continued, if slower, economic growth in 1985 is the combination of wage and price moderation, both of which appear likely to be sustained. However, if wages were to rise rapidly in 1985 (which is unlikely), or if prices were to rise rapidly in that year (more likely to occur, especially if the money supply is expanded and interest rates fall), a turndown in the economy could occur earlier and at a faster pace in 1985 than I previously predicted."

Dan Mitchell suggested that some isolated event could cause a sudden sellout of dollars and U.S. investments by foreign owners. The dollar would depreciate, inflation would be triggered, the Federal Reserve would act to increase interest (partly to attract foreign capital back, partly to dampen inflation), and a recession would ensue. But he did not give the scenario much credence. His analysis:

> "The economy currently does show signs of slowing from the rapid pace of expansion during the first half of 1984. It may even 'pause.' But recession will not begin. Big federal deficits do not necessarily cause recessions unless they trigger inflation that the Federal Reserve finds unacceptable. Deficits do reduce the rate of national saving, which means less investment and/or more borrowing from abroad."

John Richardson focused on the deficit as a cause of instability in his own prediction of growth:

> "Private credit demands will begin to clash seriously with federal financing requirements in the first half of 1985, as a result of the huge structural budget deficit. At this juncture, the Federal Government's demand for the limited supply of savings will begin to 'crowd out' private-sector demand, pushing up interest rates on a long-term cyclical basis and preventing any future growth. Nothing has been done to date to correct this structural deficit and to change the current game plan."

The consensus forecast, offered after this discussion, is that employment will continue to expand at about the same rate as the labor force grows. Consequently, unemployment will be stable. All agreed that efficiency drives among employers are still on, and still cutting labor input.

Compensation

There is almost no upward pressure on wages in the economy, so whatever increases are occurring are quite spontaneous. First, *inflation* (steady, and about 4 percent) is not causing a clamor for more pay "to keep up." Second, *union power* to push for wage hikes has faded fast where employers resisted them. Finally, *labor supply* is generally abundant, so bidding up wages to acquire employees from another firm seldom occurs. There is nothing in this economy to generate compensation increases.

In 1985, the panel sees the same situation. It expects a modicum of added inflation, but no increase in union power or tightening in the labor market. So, its wage projections are just a small amount higher than at present (Table 1). Robert Neylan summed up his point of view as follows:

> "Employers are budgeting between 5 and 6 percent for salary increases, and slightly less for hourly payrolls. With inflation down from the 1979-1980 levels, and unemployment still high, bargained increases are still going to be at moderate levels. There are 106 million people employed, but no one is expecting a big pay day; those who are employed are glad to be employed and simply want to stay even with whatever the level of inflation turns out to be."

David Lewin and John Richardson both emphasized that there will be considerable variation from the overall rate of increase. Lewin said:

> "White-collar workers in industries in which firms are continuing to follow long-term reductions in force—industries such

as oil and insurance—will receive only modest pay increases, say 3.0 to 4.0 percent. White-collar and professional employees in the computer and office machine industries will receive larger increases, on average, say between 6.0 and 9.0 percent, but this will depend heavily on the size and market position of the firm in which they are employed. Some occupational specialities—such as computer programmers, systems analysts, petroleum engineers, geologists and managers of financial services—may well receive double-digit pay increases in 1985.

"In contrast, production workers and other blue-collar employees are likely to receive relatively modest pay increases in 1985, say from 2.0 to 5.0 percent depending upon the industry and firm in question. Wage increases that go into effect in 1985 as a result of collective-bargaining agreements negotiated previously and first-year wage increases resulting from newly bargaining (1985) labor agreements will be modest, in the 2.0 to 4.0 percent range.

DAVID LEWIN
Professor of Business
Graduate School of Business
Columbia University
New York, New York

"In 1985, I also expect to see the expanded use of profit sharing, bonuses and employee stock-ownership plans for non-management employees as forms of compensation. These will reflect the continued trend toward the use of productivity and ability to pay as major wage-setting criteria, a trend which began to be observed in the early 1980's. Correspondingly, less emphasis will continue to be placed on inflation and comparability in the determination of wages in the U.S. economy in 1985."

John Richardson emphasized industry variation:

"As economic growth extends, wage gains will begin to rebound. However, as economic growth has been uneven among the various sectors, so will the wage increases. Those industries still experiencing difficulties (including steel, aluminum, airlines and agricultural implements) will probably continue wage freezes and, in some instances, will extend wage cuts.

"Wage growth will be held in check to the 6 percent level because the unemployment rate will cut into employee bargaining power. In addition, as productivity growth is expected to be moderate (3 percent), this will tend to keep a lid on unit-labor costs. Finally, companies need to help keep unit-labor costs down in order to keep prices down. The increased competition stemming from deregulation in various industries, the flood of lower-price imports resulting from the strong dollar, and the emergence of very competitive nonunionized industries all point to a tightening in compensation.

JOHN J. RICHARDSON
Vice President-Industrial Relations
Northrop Corporation
Los Angeles, California

"Additionally, unit-labor costs will remain low for three primary reasons:

(1) reductions in the labor force due to layoffs;
(2) continued wage concessions in labor contracts;
(3) more efficient and effective management of labor.

"The first two factors are clearly evident in the construction, airlines, steel, rubber, auto and energy industries. These industries have been extremely hard hit by the past recession. In many cases, their only alternative to remain competitive within their markets was to reduce labor costs. This was accomplished by layoffs and seeking wage concessions from their unions. Only recently have many of these depressed industries experienced any true growth."

The wage forecasts in Table 1 all refer to nonexempt employees: production, clerical and nonsupervisory workers of all types. Information in the box on page 9 covers forecast increases for several levels of employees of private businesses, surveyed by compensation consulting firms. These are generally 2 to 3.5 percentage points higher than the increases for nonexempt workers upon whom the panel focused.

Skill Shortages and Labor Market Operation

As the labor market tightens, shortages of some kinds of workers appear. Employers, bidding such workers away from other jobs, escalate wages in those occupations. This wage bidding may be confined to a particular geographic area, or specialized industries and specialized technical occupations and backgrounds. While the panel did not identify this type of wage escalation problem in the 1985 labor market, it did devote much discussion to mismatches between the skills and qualities that employers are seeking and the available labor force. There was little resolution of the question: Is the labor market operating efficiently?

There are shortages of technically trained professionals, such as specialized engineers and computer scientists; there are also shortages of technical craft workers, such as tool and die makers. According to panelists, the college and graduate-school population contains too few scientifically oriented students. Moreover, panelists felt that high-school graduates today lack sufficient background in basic mathematics and sciences—and are difficult to train because of this. Another theme was that potential employees are resistant to geographic relocation.

As for the already-experienced worker, there are several barriers to reemployment after layoff. Former wage scales, even for unskilled factory work, give the unemployed unreasonable expectations and a sense of disappointment at "having to start all over again." The incentive to relocate is not very strong at low wage rates, especially when the former worker will lose so much of the investment in home, in status, in job accommodation.

Ted Marston observed:

> "It seems to me that just looking at unemployment numbers doesn't really tell you what is going on in this country.
>
> "In our area of the country, there is a major problem of employment for young people (18 to 24) with only a high-school education. There are no jobs available to this group other than in fast food chains or in cleaning rooms in a motel. Therefore, many of our young people are leaving the Midwest and going to the Southwest.

TED L. MARSTON
Vice President-Personnel
Cummins Engine Company, Inc.
Columbus, Indiana

> "Retraining is another critical issue. We are finding that many workers who are being retrained have low skills in reading, writing and math. Because of their skill level they are forced to accept jobs at a substantially lower rate than the wage they received at Cummins. There are many examples of people going from $20,000-a-year jobs to $8,000-$10,000-a-year jobs."

The discussion underlined the existence of strong employer demand—in specific locations, for very specific skills and background, mostly technical—at the same time as the unemployment rate seems "stuck" above 7 percent. The highly anecdotal discussion indicated that the U.S. labor market, flexible and responsive as it is, is not operating at full efficiency in this recovery. There seems a strong possibility that we are underinvesting in the employment adaptation of our population.

Protectionism

Protection from competition, though not part of the present Administration's philosophy, has been extended to "political" industries such as steel, autos, textiles and apparel, and sugar. Frequently, the main justification is to sustain employment in the competition-threatened industry. While it is difficult to assemble a constituency of "consumers for free trade," the *industrial* consumers of, say, copper, can organize to forestall protection and price increases.

DANIEL J.B. MITCHELL
Director, Institute of Industrial Relations
University of California
Los Angeles, California

The question is: What extensions of protection might develop in 1985? Dan Mitchell commented:

> "Steel never gets all the protection it wants, but it always gets something when it makes a push. Just a few weeks ago, President Reagan announced in triumph that he was not going to restrict trade in steel, just get 'voluntary' arrangements with steel-exporting nations to do it for us. Since it will take some time to negotiate this deal, steel will definitely get more protection in 1985 than it has now.
>
> "Autos will probably not be made to go cold turkey into open foreign competition. Something will remain of the 'voluntary' quotas. But a second Reagan Administration will not be worried about domestic political concerns. Thus, it seems unlikely that more protection will arrive in 1985."

Robert Neylan added;

> "The Administration is targeting reductions in imports of both steel and machine tools, using its 'jawboning' authority under the 1974 Trade Act. As we limit steel imports, industries that use steel must pay a higher price. Those industries then pass the added cost on to their customers.
>
> "Any reductions in imports, and there have been some, will be 'voluntary' lest a general tariff war break out.
>
> "Our experience with deregulation suggests that we are going to be better off when the government finally gets out of the regulation business. In the airlines, we finally have some competition on at least some routes; and the traveling public is better off for it. Vested interests (the pilots, mechanics and the unions) are taking some lumps but the public is reaping the benefit. Railroads are finally in a position to compete, and they are extending their reach into other logical areas of activity. Rates are down and service is better; a shipper has a choice among forms of transportation.
>
> "Banking is the one area where I would expect more deregulation activity. It is about time for the regulators to recognize that the marketplace has long ago passed them by. In 1982, the Gara-St. Germain Act authorized banks to expand into financial services, long after so-called nonfinancial institutions had created a whole new market in services.
>
> "Without doubt, there is sentiment for reregulation. It is typically motivated by self-interest but does not, at this point,

ROBERT NEYLAN
Vice President-Employee Relations
Gould Inc.
Rolling Meadows, Illinois

contemplate restoring regulation to prior levels. Railroad consumer groups would like to water down the Staggers Act of 1980 because it is in their direct interest to do so. The insurance industry is said to be lobbying to stop banks from getting into the insurance business. The surviving truckers want to reregulate to stop new truckers from entering the business and for a form of rate control to end pricing wars. *Everyone favors the free market—except in their own backyards.* Competing is hard work—who needs it if there is an easier way?

"Steel capacity will continue to decline as the industry adapts to the changes that have taken place in the world. Companies will concentrate on specialty items where they can capitalize on their expertise or technology. The mini-mills are here to stay, since they can make a profit at reduced levels of operations. Steel companies have already branched out into financial service and oil, and more will diversify as it becomes clearer that Uncle Sam is not going to protect them.

"Railroads, trucks and barge lines will increasingly compete and the strongest—those that can offer service at competitive rates—will survive. Railroad mergers are commonplace and there will be more. Railroads are expanding into trucking and eventually, like CSX, some will recognize opportunity in the barge and airline business."

John Richardson noted that protection cannot freeze out the forces reducing costs:

> "The impact of any protectionist or regulatory policy has been and always will be: (1) increased prices to the customer; (2) reduction in the competitive strength of the affected industry; (3) inflexibility to changing market factors; and (4) lack of any incentive for adaptive re-structuring to remain viable, resulting in a continuing need to remain protected or regulated.
>
> "However, those very industries remaining protected are facing tremendous global competition from foreign imports due to the strength of the U.S. dollar. As a result, even though protected, these industries need to either freeze or reduce their wage levels and/or work force in order to remain price competitive."

Collective Bargaining and the Shrinkage of Unions

The unions' loss of wage power has been a subject of discussion by the Labor Outlook panel for three years. It is now fully acknowledged. The collective-bargaining settlement data tell a story of continuing "concessions." The following tabulation shows first-year wage adjustments in contracts covering 1,000 or more workers in the period indicated.

	1983	January-September 1984
Percent of workers affected, who received wage increases:	63	73
Wage freezes	22	21
Wage decreases	15	6
Mean wage adjustment	2.6%	2.5%
Mean wage increase	5.8%	4.2%
Mean wage decrease	-6.7%	-9.0%

In the second year of recovery, union concessions are still being negotiated. Chart 1 shows that the rate of wage increase for unionized employees in the whole economy has trailed that for unorganized employees since the second year of recovery began. Dan Mitchell said:

> "I think that the wage concessions of the early 1980's were partly corrections for the widening union-nonunion wage differential in the 1970's. It is quite possible that union wage increases will continue to run below nonunion, or at least not faster."

Ted Marston surveyed recent trends and events, arriving at these conclusions:

> "Negotiated wage rates will continue to be in the same range as 1984 for heavy manufacturing. Many companies will try to establish pay systems that do not go into the base pay system, that is, bonus plans and profit-sharing plans. Also, we will see more lump-sum payments or a combination of lump sum and bonus (like GM). Negotiated variable pay systems will continue to increase over the next three to five years.
>
> "We have seen in the GM and Ford contracts that management is willing to spend its dollars on employment security and pensions. Both contracts were designed to help reduce the size of the work force. In both cases, the company was willing to pay in order to maintain its ability to move work out of the company. I believe much of this work will be moved offshore.
>
> "It appears that the auto companies decided against any long-range plan to try to retrain and redeploy their existing work force. As a result, I doubt they will get the gains necessary in productivity and quality to stay competitive with the Japanese, or even the Europeans. This must mean they are hoping for continued protection, and that they intend to automate a great deal more than they have up to this time."

Looking at the overall decline in union wage power, John Richardson concluded:

> "Unions have ceased to be the economic force controlling wage patterns and employment conditions. They are, in fact, gradually evolving into a special-interest group. The pattern bargaining of the past is no longer a viable apparatus; wage bargaining is being custom-fit to the individual needs of the company.
>
> "Reagan's reelection will foster and encourage this trend—but the trend itself is unavoidable. There are various reasons for the unions' decline in economic strength and vitality,

A Survey of Surveys: Salary Plans

	Level of Employee	*1984 Salary Increase*	*1985 Planned Salary Increase*
American Compensation Association	Executive	6.8%	6.7%
	Exempt Salaried	6.5	6.5
	Nonexempt Salaried	6.4	6.4
The Conference Board	Exempt Salaried	6.5	6.5
Executive Compensaton Service, Inc. A Subsidiary of The Wyatt Company	Executive	6.7	6.5
A.S Hansen	Executive	6.6	6.5
	Exempt Salaried	6.4	6.4
	Nonexempt Salaried	6.2	6.2
Hewitt Associates	Executive	6.8	6.5
	Exempt Salaried	6.2	6.2
	Nonexempt Salaried	6.1	6.0
Sibson & Company	Executive	6.9	6.7
	Exempt Salaried	6.5	6.5
	Nonexempt Salaried	6.3	6.3

1984 actual salary increases and those planned for 1985 are almost the same. This is a continuation of the fall from earlier inflation-driven levels where, at their peak, increases reached double digits. Even though salary increases are at their lowest level in ten years, the continued low rate of inflation is producing a real earnings gain for employees, while allowing employers to escape from the necessity of using salary increases as catch-up cost-of-living adjustments and to put more emphasis on linking pay to individual performance.

Charles Peck
Senior Research Associate
The Conference Board

primary among them is their rapid decline in membership. Total membership in labor organizations accounts for less than 20 million workers, and estimates of 10 to 15 percent of the work force being unionized by 1990 are commonplace.

"USW has lost one-half of its membership over the last three years. The shrinkage of the smokestack and basic industries, steel, rubber, auto, textiles, has resulted in the U.S. economy moving out of labor-intensive production and into capital-intensive production. Additionally, growth in high-technology manufacturing—electronics, communication, aerospace—has resulted in a restructuring of the labor markets into highly skilled knowledge workers and reduction in the number and proportion of semi-skilled craftworkers."

But Jackie Presser saw a role for unions in service industries:

"In the post-World War II decades, service-sector employment has grown dramatically, even during recessions. As business expands capacity, new industrial job opportunities open up and fuel further expansion of the service sector. The most important challenge facing the U.S. economy is to make these new industrial and service jobs ones that can support the U.S. standard of living. This is the labor movement's greatest task for the future, and in my opinion the key to building economic strength and sustaining long-term economic expansion."

Richardson's response to this suggestion was:

"As the basic industries began to reduce their work forces and concession bargaining became the predominant pattern, there has been less and less incentive for workers to unionize. Workers no longer view unions as a means to assure income and job security. Those industries most heavily unionized were hardest hit by the recession and the last to recover. White-collar workers in the service and high-tech industries have never been prone to unionism, and they never will organize unless unions develop an appropriate strategy for recruiting them.

"Management is practicing more enlightened personnel policies. This is apparent in the number of quality-of-worklife programs being pursued, the greater attention to the development of effective communication programs, and the growth of productivity-improvement programs with pay-for-performance compensation schemes. In these circumstances, unions have very little opportunity to recruit members."

David Lewin closed the discussion with this statement:

"The AFL-CIO and major constituent unions might begin to reassess their basic political, organizing and bargaining strategies. The combined tide of public and business opinion is running strongly against organized labor and, together with the continuing decline in the proportion of workers organized, this presents a major challenge to union leaders to reassess their

Employee Commitment Requires Employment Security: Ted L. Marston

"Another approach is to ensure the people in your work force that their employment will be secure if they really work hard at increasing productivity and improving quality. Then you develop *all* of the people into a highly trained, highly effective work force. Those who lose jobs because of productivity gains will be trained to do new work that has been brought into the organization.

"One of the vital leadership tasks is to identify and procure work necessary to keep your work force challenged and growing. The redeployment and retraining of the work force is a central role for everyone. Then new work is only brought in if the job design and methods are so effective that the work can be done as cheaply in-house as by others. This forces the organization to look at new ways of doing work. It forces managers to redesign work and train people to produce more effectively than in the past.

"If you have a unionized work force, it allows you to talk about how work can be done more effectively. You work together in designing the work for flexibility. It gives ownership to everyone involved in making the change."

> basic strategies. If they fail to do this, they will surely continue to experience declines in number and proportions organized, political influence, and public standing. The Reagan victory may be good for organized labor—if it brings about a major reassessment on the key fronts noted above."

Returning to union bargaining, the panel predicted first-year wage and benefit increases in major contracts (those covering 1,000 or more workers) of 4 percent. Taking benefit inflation into account (as the data in our text table do not), this projected rise is slightly greater than the 1984 experience to date. This suggests fewer concession contracts, with wage freezes or cuts, than in recent years. Mr. Presser said:

> "Negotiated wage settlements for 1985 will be very similar to contracts negotiated in 1984. Wage increases for employees will go up slightly—but unions will continue to negotiate lower new-hire rates, and wage progression scales for new hires that stretch out the length of time required to reach the top of the scale. Employers will continue their attack on work rules and paid time off, concentrating on restricting the application of premium pay provisions, increasing flexibility in making job assignments to workers across job classifications, and reducing the number of personal and sick days."

The 1985 collective bargaining calendar (Table 2) includes some negotiations that used to be notable national "events" in the wage reverberations they caused, and in their sheer size and comprehensiveness across an industry. Now the structure has shattered and "industrywide" is inapplicable—nor is companywide appropriate. The Chrysler negotiations in the Fall of 1985 are separated from 1984's General Motors and Ford bargain by a year, and by different wage levels and formulas (there is no profit sharing at Chrysler). The rubber bargain next April has already become "a smashed system, with concessions going down to the plant level," as Dan Mitchell put it. In trucking, side agreements have already excepted companies and units from the "master" agreement. Earl Royse said:

> "The most interesting labor development in the trucking industry is the revelation that only 29 large truckers (so far) will participate in group bargaining next Spring under the mantle of Trucking Management, Inc. This is down from 125 in the last round of negotiations, and some might say that this could hardly be called 'industry' bargaining. Apparently, many of the rest of the employers intend to go their independent ways, although some may play 'wait and see' on how bargaining progresses. This alone may provide an incentive to the Teamsters to produce a workable pact, since it can be presumed they would not like to see their national agreement under glass at the Smithsonian Institution any time soon.
>
> "After the three-year wage freeze in 1982, it seems that the union has to produce something this time. But the average wage and benefit cost of unionized carriers is now about $18.50 an hour, which is in some cases 50 percent higher than that of nonunion rivals. Thus, the union's choice appears to fall between delivering for the members and drastically complicating its bargaining structure. The logical solution seems to be a moderate compromise with no strike—if the rank and file allows it. Our guess is that they too will see that a threat to industry bargaining is also a threat to them in the long run."

Jackie Presser acknowledged the pressure that industry-wide bargaining is under, and said its source is deregulation:

> "Nearly 100,000 of our members are ~~out of work in the~~ trucking industry. According to the American Trucking Association, 350 large carriers have failed since the implementation of the Motor Carrier Act of 1980 (the legislation deregulating trucking). Deregulation has exacted a tremendous price in human terms from Teamster members, and as an economic experiment it is a failure.
>
> "Devastated by deregulation, the trucking companies sorely needed the wage freeze we negotiated in 1982, and our members made the sacrifices necessary to help the companies. Outrageously high health-care costs have forced the additional sacrifice of diverting the members' annual cost-of-living increases to the health and welfare and pension funds. Our members are looking forward to a wage increase this time, but they realize they are dealing with a crippled and realigned industry and their demands are reasonable. The bottom line is job security. The threat of job loss has been like a cocked pistol held to the heads of Teamster truck drivers since deregulation started. We have given the companies wage relief, now our members need a little relief in their overly tightened belts."

David Lewin noted:

> "In trucking, the major issues will be decentralized versus centralized bargaining, the regionalization or localization of pay rates, and responses to the nonunion trucking sector. I also expect that changes in work rules will be sought by employers. An issue that may affect both parties is an attempt by the Congress to strengthen incentives for states to enforce the 55 mile per hour speed limit, although countervailing forces support-

Table 2: Events on the Collective Bargaining Calendar for 1985

Month of Contract Expiration	*Industry*	*Company or other detail*	*Union*
January	Food	Sugar Companies, Hawaii	Longshoremen
	Transportation Equip.	AMC, Ohio, (Wisconsin in Sept.)	Auto Workers
	Retail	R.H. Macy & Co.	Retail, Wholesale, Dept. Store Union
	Textile	Burlington Industries	Clothing & Textile Workers
	Transportation	S. California Rapid Transit	Transportation Union
		Eastern Airlines (also April, May)	Machinists (Transport Workers, Pilots)
February	Communications Media	Television basic contract	Writers Guild
	Retail	Stop and Shop Supermarkets	Food & Commercial Workers
March	Transportation	Trucking Management Inc.	Teamsters
		Motor Carrier Labor Advisory Council	Teamsters
		Cartage Exchange of Chicago	Chicago Truck Drivers (Ind.)
	Retail	Bloomingdale Brothers	Retail, Wholesale, Dept. Store Union
	Food	Anheuser-Busch, Inc..	Teamsters
	Transportation Equip.	Budd Co.	Auto Workers
	Utilities	Commonwealth Edison Co.	Electrical Workers (IBEW)
	Construction	Local multiemployer contracts expire throughout March-July period	Construction Craft Unions
April	Rubber	Firestone, Goodrich, Goodyear, Uniroyal	Rubber Workers
	Hospitals	Affiliated Hospitals, San Francisco	Service Employees
May	Clothing	Clothing Manufacturers Association	Clothing & Textile Workers
		New York Coat and Suit Assn.	Ladies Garment Workers
		Affiliated Dress Manufacturers, Inc.	Ladies Garment Workers
	Hotels	New York City Hotel Assn.	New York Hotel & Motel Trades Council
	Paper	Contracts expire at many paper plants throughout May & June	Paperworkers
	Textiles	J.P. Stevens; Cone Mills; Dan River (June)	Clothing & Textile Workers
	Transportation	San Francisco Employers Council	Teamsters
June	Electrical Equip.	General Electric (Westinghouse in July)	Electric Workers (IUE, UE, IBEW)
	Transportation	Trans World Airlines	Airline Pilots
	Shipbuilding	General Dynamics	Metal Trades Council
	Food	California Processors, Inc. & Frozen Food Employee Assn. (Cal.)	Teamsters
	Retail	Jewel Food Stores	Food & Commercial Workers
	Service	Seattle Area Hospital Council	Washington State Nurses Assn.
	Utilities	Union Electric Co. (St. Louis)	Electrical Workers (IBEW) & Operating Eng.
		Georgia Power Co.	Electrical Workers (IBEW)
July	Communications	Western Union	Telegraph Workers
	Utilities	Pennsylvania Power & Light Co	Electrical Workers (IBEW)
	Communications Media	Alliance of Motion Picture & Television Producers (Los Angeles)	Theatrical Stage Employees
August	Electrical Equip.	Raytheon Co.	Electrical Workers (IBEW)
September	Food	Morrell, Swift, and Wilson	Food and Commercial Workers
	Transportation	American Airlines	Transport Workers
	Finance	Prudential Insurance Co.	Food & Commercial Workers
October	Glass	Libbey-Owens-Ford	Aluminum, Brick, & Glass Workers
	Transportation Equip.	Chrysler Corp.	Auto Workers
November	Aerospace	Pratt & Whitney, Aircraft Div. of United Tech.	Machinists
		Hughes Aircraft	Carpenters
December	Utilities	Southern California Edison Co.	Electrical Workers (IBEW), Utility Workers
	Electrical Equip.	RCA Corp.	Electrical Workers (IBEW)

Source: Bureau of Labor Statistics and Bureau of National Affairs, Inc.

ing removal of this legislation may well develop in 1985. In any case, labor and management in the trucking industry cannot ignore this issue, given that the absence or presence of the law as well as its enforcement can affect firm performance, employment and employee compensation."

Mr. Presser, aware of the issue, stated:

> "In the interest of safety for the truck driver and traveling public, I am also concerned that, in the event of the 'sunset' of the Interstate Commerce Commission, all of the Commission's responsibilities for overseeing the safe transport of goods be transferred to an appropriate agency within the Federal Government—an agency that has sufficient staff and funding to pursue these safety requirements aggressively. I would not want issues of truck safety to be submerged in general concerns about highway safety. The special concerns of truck safety are, to a large extent, different from general highway-safety problems and warrant special attention by whatever oversight body will have jurisdiction."

Rubber bargaining was one of the earliest examples of pattern fragmentation in 1980.[1] Now, according to Earl Royse:

> "Successful proposals for union concessions did not end with recession. Producers have negotiated changes in work rules to allow greater use of their facilities. One major change has been conversion to seven-day-a-week operations, with employees working on weekends at straight time whereas they previously received time-and-one-half on Saturdays and double time on Sundays. At General Tire & Rubber's plant in Charlotte, N.C., this was achieved only after a 4-month strike. About half of the workers received immediate pay increases. Not all union locals have gone along with this trend, but the seven-day workweek is becoming much more common in the industry. The moral of the story is that even if the statistics begin showing rising wage rates, these may well be offset, or more, by work-rule changes and other concessions that show up only in productivity figures."

David Lewin explained the continuing concessions:

> "The rubber industry will continue to experience both international competition in the rubber-tire market and domestic competition from firms in the plastics and petrochemicals industries that produce products which, in some cases, act as substitutes for rubber products. Hence, the rubber industry will face ongoing pressure for labor (and other) cost containment. I expect this to translate into company bargaining objectives that include small rates of pay increase, no changes in fringe benefits, increased flexibility in work rules, freedom to subcontract work, and freedom to close and relocate plants. The United Rubber Workers will probably seek some job security through retraining and income-guarantee provisions, in return for agreeing to one or more of management's bargaining goals."

In his comments on this subject, Robert Neylan coupled the rubber bargain with the General Electric and Westinghouse negotiations:

> "I think that the dominant effort in the 1985 bargaining will be directed toward job security. Wages and benefits will be secondary in importance. The manufacturing industries that bargain in 1985, electrical and rubber for example, have undergone radical change during the past several years. Electrical manufacturers have recognized that fabrication and assembly can be separated without loss of efficiency. Thousands of assembly jobs have left the Northeast and settled elsewhere. You can't go into a Rio Grande border town without tripping over an electrical assembly operation run at lower cost, and with efficiency equal to the best New England has to offer. Advance notice of closing, severance arrangements, and retraining programs have to be high priority subjects for bargaining. The real issue is whether they will have any effect—or has the horse already left the barn?"

Dan Mitchell wondered whether the electrical equipment companies will try to obtain concessions now, and be resisted:

> "GE must be wondering whether it missed out on something in recent years. It bargained through the concession era in 1982 as if nothing had happened. GE has a reputation for shifting bargaining tactics when the moment is opportune. Perhaps, like the hotel owners in Las Vegas, they might want to 'test the waters' to see whether some belated concession might be obtained. If so, this could lead to confrontation."

The panel was asked if the steep concessions in construction during 1982-1984 were at an end. Mitchell said:

> "Construction has been the heartland of concession bargaining. Someday the concessions will have to end. But the pace of concessions was so great last year that we thought that there were still some in the pipeline. The pace is still strong. And the UCLA business forecast does not project much employment growth in construction during 1985. Concession bargaining will taper off in construction, but there will still be some in 1985."

Robert Neylan reviewed the reasons for construction unions' loss of power:

> "A major influence is the continued growth of the open-shop firms that are now doing as much as 70 percent of all building. The open-shop operators are expanding rapidly in commercial and industrial building, which formerly was exclusively union territory. Even in the face of a construction boomlet, union contractors will approach the table knowing that cost increases can't be passed through to owners as readily as they were in the 1960's and 1970's. The open-shop contractors are big enough and strong enough to take on practically any project.
>
> "In the past, industrial unions used their strength to support their construction counterparts. An industrial company would think twice about letting a contract to an open-shop contractor because of the effect on its production workers. Now,

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[1] For examples, see Audrey Freedman and William Fulmer, "Last Rites for Pattern Bargaining." *Harvard Business Review*, March-April, 1982, p. 40.

> while there is ample capital available, no one is going to spend more than is necessary for a plant expansion, or a new plant, simply to appease a plant's production work force. Industrial workers have had enough problems of their own recently, and are not as likely to jeopardize their pay checks on behalf of brotherhood as they once were.
>
> "Contractors were able to drive hard bargains in the past several years, extracting concessions and no-increase deals as a result of the recession. Most of the contracts signed in the recent past have been for one year and many will open in 1985. While business will be good in 1985, it will be down from the robust condition in 1984. The time of concessions is over in construction—but there is sufficient uncertainty remaining to induce caution on both sides of the table."

In discussion, one panel member observed that unions will continue to organize members whose wages are subject to forces beyond the unions' control. This will be the future of the U.S. labor movement. No one disagreed with this gloomy analysis of union power; the description of current bargaining seemed to verify it.

Public Policy and Legislation

The panel expects no major initiatives in legislation in 1985. However, it does anticipate major debate on tax policy. The tax system and its details are actually social policy—so the coming clashes in tax "simplification" will be public debates on social values and goals. Meeting two days after the reelection of President Reagan, the panel was unwilling to go much farther than the above statement.

One of the tax-supported income-transfer systems that is very close to the employment relationship is unemployment insurance, which has been buffeted in two deep recessions. The panel was asked: Will there be any changes made in UI in the relatively calm period they predict for 1985? The answer is "no."

Robert Neylan said the idea of voluntary individual accounts, to be used for job training in the event of layoff, probably will not be adopted.

> "In view of the increasing concern over the deficit, I doubt that this concept, embodied in a proposed National Individual Training Account Act, has much chance of passage. Unemployment is a major national concern, but this type of legislation does not address the problem of the long-term unemployed, particularly those who have little chance of ever returning to their previous occupations because of structural changes in the economy.
>
> "The Job Training Partnership Act, signed into law in 1983, has helped a significant number of participants to find work after completing the program. On the surface, at least, it is a successful response to unemployment although critics say that the program discriminates in favor of those who have skills, either by virtue of education or experience, upon which a new career can be built. Linking the unemployment insurance system to training would be costly—providing tax credits for participating employees and employers. Such a scheme helps only those who are equipped to take advantage of it. The hard-core unemployed, and those who don't have the background required for meaningful retraining, would be left where they were before—on the dole and without prospect of employment. Arguably, those who benefit from this type of plan have sufficient resources to land on their feet without any additional expenditure of government funds and without further intervention by government agencies."

However, he approves of income support during training:

> "Candidates screened for participation in the Job Training Partnership program continue to draw unemployment insurance in some states, and I see no reason why this benefit should not be continued in similar circumstances. This simply recognizes the difficulty of concentrating on learning a new skill while eating your way through your savings. Care would have to be exercised to ensure that the training leads to a viable opportunity and that the participants are qualified and maintain standards of performance. The GI Bill of Rights was the most successful education-training program in U.S. history, but a small portion of its benefits were wasted on inappropriate activities which passed for education."

John Richardson advocated conditioning extended unemployment benefits on participation in a training program, specifically a National Job Training Partnership Act program. Presser agreed with him:

> "Existing unemployment insurance regulations discourage individual efforts at retraining. If an unemployed worker is enrolled in a Job Training and Partnership Act program, or in other government or private training and education programs, that worker is 'unavailable for full time work' and, therefore, ineligible for unemployment benefits. This should be changed so that enrollment in training and education programs does not mean automatic ineligibility for benefits. Some consideration should be given to the trainee's willingness and ability to work full time while attending training and education classes."

In regard to the labor-relations laws and regulation by NLRB, the two academic panelists thought deregulation trends might extend to this legal byway. David Lewin said:

> "I think that labor-law reform of some type is likely to occur in 1985. There is a possibility that some sectors now covered by the Taft-Hartley Act will be removed from coverage (construction, apparel manufacturing and trucking). There is also a possibility that airlines will be placed under Taft-Hartley; that is, removed from coverage under the Railway Labor Act. I believe that railroads will continue to be subject to the Railway Labor Act in 1985 in so far as labor relations are concerned, but the Act may be modified or streamlined, especially to reduce the time spent on mediation of labor disputes. This will depend in large part on the fate of other newly emerging legislative initiatives to deregulate the railroads as a sector of the economy."

Dan Mitchell said:

> "A second Reagan Administration may not be content with simply making appointments to the NLRB; some future Presi-

> dent could always appoint new people with different views. There will be strong pressure from within the Administration (not from major employers that are already unionized) to leave a legislative 'legacy.' The chances are that a sharp departure from the existing Wagner-Taft-Hartley framework would not get through Congress. But what would the Administration lose by trying?
>
> "The official policy of the National Right to Work Committee is that it opposes compulsory union membership, not unions per se. So one line of attack might be a national 'right to work' law. But extending that logic could lead to an attack on the principle of exclusive representation. You wouldn't have to change much in the text of the Wagner Act—just a slight rewording of Section 9 would do it. Combine this with a slight rewording of Section 8, and employee representation plans (company unions) could be revived, perhaps as quality circles or productivity committees. In short, radical changes could be made in labor law with only minor rewording that would not appear radical. And it could be packaged with catch phrases about productivity, cooperation, consultation with employees, and so forth. Add to this brew recent statements by Lane Kirkland to the effect that the Wagner-Taft-Hartley framework has become an albatross and the possibility for a major alteration in public policy is enhanced.
>
> "On the other hand, the Railway Labor Act is really a sideshow because of its narrow focus. Unless the unions and employers involved were anxious to change the law, why would Congress bother with it? No one has been perturbed for half a century by the fact that railroads and airlines are under a separate statute. Why should Congress get excited about it now?"

In discussion, the panel did not foresee major legislative attention to labor law in 1985.

Immigration control will come up again, and the panel thinks that this time a bill will be passed. Bob Neylan said:

> "Three years ago, I thought that immigration reform hadn't a prayer of passing. At this point, it looks like an idea whose day has come."

Earl Royse added that "control by employment sanctions is probable." The panelists thought that passage would be easier in 1985, because there are no congressional elections until 1986.

Taxation of health-benefit contributions by employers as employee income will be proposed, but the panel expects it to be rejected. Bob Neylan said:

> "Unfortunately, the outlook for legislation is fairly good. Its supporters sell it as a revenue raiser, a strong message in the face of a massive deficit. It is also viewed as a cost-containment measure since it will, presumably, reduce the demand for health services. The extent to which it will do either is pure speculation.
>
> "The notion of taxing benefits at any level has so little appeal that it will be vigorously opposed by business, and by labor as well. The President might be able to force it through by arm-twisting since it appears that he is personally committed to the principle. There are better ways to raise revenue, and health-care cost containment is being addressed in the private sector with more vigor than in government."

Earl Royse suggested that some taxation of health benefits would pass:

> "While there will be great debate over 'basic' tax reform, it is almost a certainty that proposals for significant broadening of the tax base will include employee benefits. Such tax debate will also be accompanied by massive lobbying efforts from corporations and the labor movement to protect the employee-benefits tax incentives that have been in place over the past forty years.
>
> "Despite the debate and lobbying efforts, the growing deficit will probably force examination of all major revenue sources. Employee benefits will not escape, since they represent such a potentially enormous contribution to the base. It seems highly probable that a cap will be placed on untaxed employer health-care costs—with amounts above the cap taxed as employee income. If this is a likely outcome, the remaining question is 'How much of the employer's premiums will remain untaxed, and will they be indexed to the CPI?' "

After discussing this proposal for a while, the group concluded that tax policy on health benefits will not be changed, because so much opposition will develop. (The subject of voluntary employer and union health-care cost containment was fully discussed in Labor Outlook 1984, Research Bulletin No. 150, pp. 12-13. For this reason, the material is not reviewed here.)

Longer-Range Human Resource Issues

During its discussion of skill shortages, the panel remarked how widespread the report of unfilled positions has become. These anecdotal shortages are most often cited in technical occupations. However, panel members described a dearth of competent service workers as well—a shortage that is occurring in a labor market with 8.4 million looking for work.

This simultaneous shortage and oversupply of labor appears to be endemic, a "constant." However, the panel feels that it is growing. What are the causes? One is the likelihood that society is underinvesting in training and competence-enhancing education—and that the investments that are made are misdirected. A related problem—broadly stated—is a weak labor market "infrastructure." The information that should channel educational investment is lacking, so young people do not find and take appropriate scientific and basic skills training. Job market information is worse than fragmentary, it is misleading and out-of-date. The immobility of the labor force may be increasing from lack of a strong labor-market infrastructure. Young people take part-time service jobs in depressed areas, while jobs with major training components and career potential go begging in other areas of the country.

The panel raised this long-term problem, because of the felt presence of extreme inefficiency in labor markets. It did not offer any resolution, nor did it lay blame anywhere. The problem seems certain to be raised again.

A second long-term issue discussed briefly by the panel deals with employee interests. A panel member observed that company "efficiency drives" are still strong and will continue as competitive pressure increases. At the same time, some counterpressures protecting employees from overzealous cost-cutting are disappearing. There has been a decline in occupational health and safety enforcement; a decline in equal opportunity enforcement. Union power is fading. Under these circumstances, are lower-level employees much more vulnerable to exploitation than in the previous two decades? The question was left hanging—but the panel has selected another long-term issue for the mid-1980's.

The short-term, 1985, outlook can be summarized as follows: a stable unemployment rate; wage increases slightly greater than in 1984, with inflation and unit-labor cost also slightly higher. No recession is foreseen for the next year. No major changes are expected in public policy, legislation or administration of the laws affecting human resources in the U.S. economy. Union decline will continue in 1985. Finally, competitive pressures on employers will sustain efficiency drives, even though the recovery is aging.

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The 1985 U.S. Economy: No Crisis, No Comfort

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Chickens Drifting Home to Roost

Edgar R. Fiedler

Meeting in the late Fall, members of The Conference Board's Economic Forum found themselves in more-than-usual agreement about prospects for 1985. Parts of the outlook—no recession and no outbreak of inflation—are reassuring. But other projections, such as a renewed rise in interest rates, further deterioration in the U.S. international deficit, and no progress on the budget front, are seriously worrisome.

As Forum members read the economic tea leaves, the current lull in the economic recovery—the "slowdown" or "pause" or "growth recession," call it what you will—is likely to give way to renewed but moderate expansion beginning in the first or second quarter of the new year. At the moment there are no signs that renewed growth is imminent, and thus a clear risk exists that, instead of regaining strength, the economy could fizzle out into a full-fledged recession. But the classic qualities of a culminating business cycle are absent: We see no evidence of serious cyclical maladjustments such as exhaustion of demand, overbuilt inventories, excessive investment, accelerating inflation, and the like.

To the contrary, several sources of strength are present to fuel renewed growth. Following the strikes of this past Fall, the scheduled increase in automobile production will, by itself, add 1½ to 2 percentage points to the first-quarter change in real GNP. Weapons production, which lagged for a while, is moving forward again. The decline in interest rates, which may continue for a while, is encouraging homebuilding and consumer purchases of other interest-sensitive, big-ticket items. Moreover, the economic lull coupled with the benign inflation picture have put aside the Federal Reserve's mandate for restraint, at least for now, and have left the monetary authorities free to be as accommodative as they might choose, pending further economic developments. Indeed, several of the Forum participants contend that the Fed is already actively embarked on this course. Another source of strength is to be found in the state and local governments, which are discovering that their budgets are in much better shape, and thus are stepping up their activities. And the financial position of consumers, while not as good as a year ago, is still basically strong. Consequently, there is wide agreement that a moderate pace of advance is the most likely prospect for 1985.

A strong consensus also emerged on the favorable outlook for inflation. Considerable slack exists in both product and labor markets. In internationally traded goods, competition is fierce and price levels are, if anything, falling. Despite the recovery, wage-rate changes have not accelerated and, in fact, may still be subsiding very slightly. Food and energy prices show no sign of making trouble. The productivity story is not encouraging, however. The gains of 1983 and early 1984 reflected the vigorous economic recovery of that period, but no more than that; thus there is no evidence that the underlying trend of productivity has accelerated from its desultory performance of the 1970's. Nevertheless, the inflation outlook is really quite good, even without help from efficiency gains.

Edgar R. Fiedler

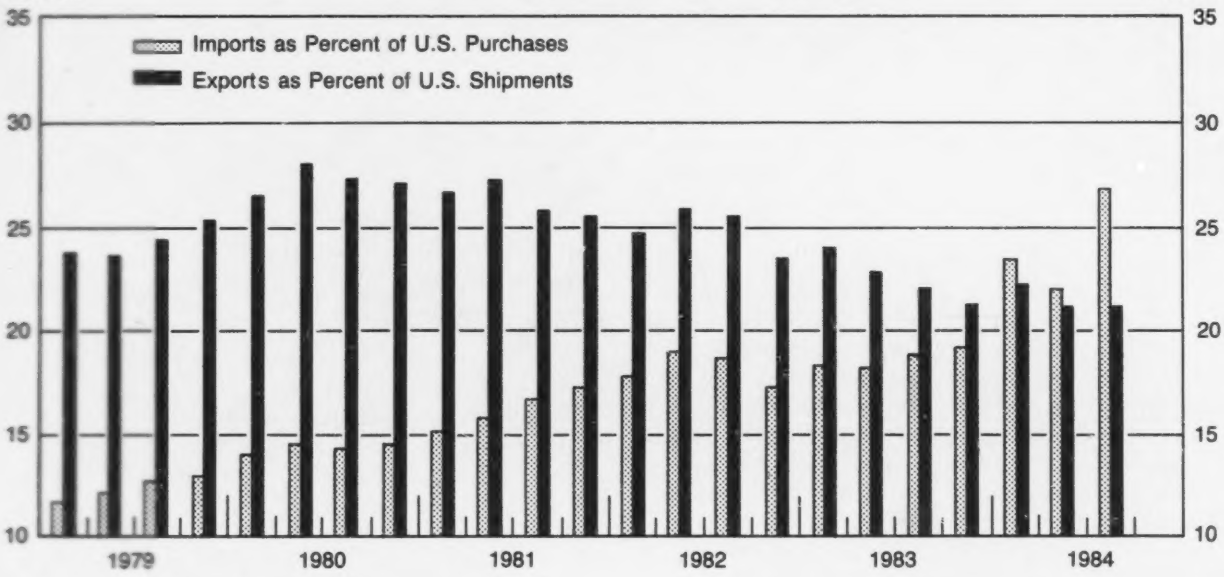
Threat of starving the sources of productivity growth.

The one risk on inflation is from the exchange rate. Because of normal lags, the sharp climb in the international value of the dollar through the late Summer of 1984 is continuing to have a dampening effect on the general price level. If the dollar should fall sharply, however, that downward pressure would wane and then become inflationary. But even if the dollar were to fall sharply now, the switch to upward price pressures would not be felt with any intensity until late 1985. Furthermore, Forum members are far from confident they can say where the dollar is headed: A majority guessed it would stay about where it is for the next year, but a sizable minority said it would be down markedly. In any event, the group agreed that the general price level would rise 4 to 5 percent in 1985 with no significant change in that trend during the year.

Most surprisingly, there is agreement—not unanimity, but a fair amount of agreement—that interest rates will rise again during 1985. Although some felt the recent declines could persist for a while, the general view is that, between now and the end of next year, pressures from an expanding economy coupled with the Treasury's enormous financing requirements will push rates a percentage point or two higher than they are today. In turn, those higher rates could bring on another growth recession in late 1985 or 1986.

Foreign Inroads

The international dimensions of the U.S. economy is a topic the Forum returned to again and again. It is these conditions, along with high interest rates, that are the major reasons why renewed economic expansion is expected to be sluggish and uneven in 1985, rather than vigorous and across the board.



Imports and Exports of Capital Equipment

Import penetration is ravaging employment and profits in industry after industry, especially in the Midwest, and the detrimental effects are fanning out to all sectors of the economy. How rapidly this is taking place in the machinery industry, for example, is illustrated by the accompanying chart. Another example, among many that might be cited, is computer-related supplies, where the United States had a huge international surplus 18 months ago, and today has a deficit. U.S. consumers are benefiting, of course, but the phenomenal speed at which our producers are losing markets is an extremely serious problem. The adjustment process cannot begin to keep up with it. Trade in the so-called "invisibles," such as net investment income and tourism, is shifting violently too. Albert Sommers quipped that he has been to Europe twice in recent months "without ever once seeing a European." Since the 1984 rise in the exchange value of the dollar has not yet been fully reflected in the marketplace, the worst may be yet to come in our trade and current-account balances.

David Devlin, our specialist on the debt problems of the less developed countries (LDC's), painted a relatively encouraging picture—encouraging compared to what is usually heard about this subject. For the most part, the crisis of the past few years reflected the severe worldwide recession of 1980-1982 and the absence of adjustment to those hard times by many of the LDC's. Today, by contrast, the world economy has turned around and the LDC's are, in fact, making the necessary adjustments. To the IMF and others who watch this problem, today's picture is entirely different from 1982. True, some bankers will continue to develop ulcers over it. But with both the world economy and the adjustment process looking good for 1985, Devlin sees the systemic threat to the international monetary system to be contained, at least for now. On the issue of long-term growth among the developing countries, however, he does not feel reassured.

Economic Policy

The discussion of policy focused on two issues. The most immediate is how the Federal Reserve responds to the current economic lull. As mentioned earlier, the group thinks the Fed has already, or soon will, adopt an appropriate policy—either actively spurring the economy back into the path of growth, or at least making sure monetary conditions do not stand in the way of renewed expansion.

The second and more compelling issue is the budget. All of us agree on the need to bring it under better control during the coming year as a crucial step toward reducing inflation expectations, easing pressures on interest rates, and achieving a better international balance.

In the simultaneous and circular process that so often characterizes economic relationships it is frequently difficult to separate cause and effect. This is surely true in the complex interrelationships among the budget deficit, interest rates, the exchange value of the dollar, and the deficit in our international accounts. Each of these is both cause and consequence of the others. Nevertheless, as Sommers put it, the best place to start is with the budget deficit as the basic, initiating cause of the high levels of interest rates, the value of the dollar, and our international deficit. Yes, there are other important contributing influences and many feedbacks within the system, but the budget is the lynchpin. Consequently, while there are surely different opinions within the group on some aspects of the budget issue—for example, whether policy-makers should aim to bring the deficit down to $100 billion or to zero, and just how to go about it—no one doubts that substantial movement on the budget is over-

The Forum Consensus
Results of a Pre-Meeting Outlook Survey

	Actual 1983	Estimated 1984	Projected Fourth Quarter 1984	Projected 1985	
				Median	Range
Economic Growth (Real GNP, percent change)	6.3	5.2	1.8	3.0	2.0-4.0
Inflation Rate (GNP Deflator, percent change)	3.8	3.8	3.8	4.5	3.8-5.8
Corporate Profits (After taxes, percent change)	40.0	–2.9	–2.0	8.5	0-15
Unemployment Rate (Percent, average during fourth quarter)	10.6	7.5	7.5	7.4	7.0-7.9
Commercial Bank Prime Rate (Percent, average during fourth quarter)	11	11½	11½	12-3/4	10½-14

	Actual FY 1984	Median FY 1985	Median FY 1986
Federal Budget Deficit (Billions of dollars)	175	192	210

Note: These forecasts incorporate submission by Forum participants in late November, and are based on data available at the time. For growth, inflation and profits, the annual forecasts are the percent change over the four quarters of the year, i.e., from 1984 IV to 1985 IV; the forecasts for the fourth quarter of 1984 are at seasonally adjusted annual rates.

due and, as big as the task is, that action is required on both spending and taxes.

The coming year is an ideal time to tighten fiscal policy, not so much for immediate effect but to reduce the 1986 and future deficits in a substantial and lasting way. If fully credible, such changes would be good news for long-term interest rates in 1985, and helpful to U.S. exporters and all of us for years to come.

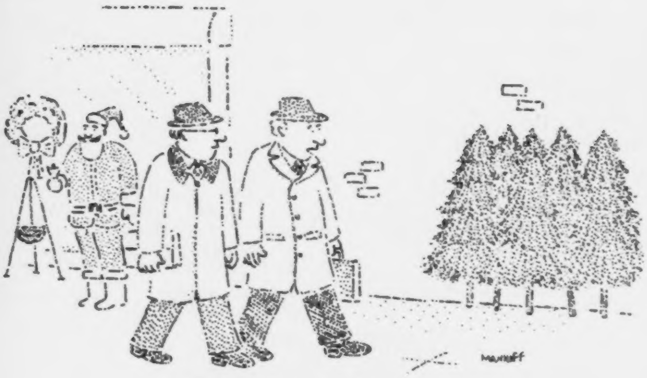
Easier said than done, however, and there is widespread pessimism among the group that meaningful budget action will be achieved in 1985. The American people don't see the deficit as a menace, and thus feel no urgency about closing it; the costs of chronic deficits are too uncertain, too distant and too complicated to be understood clearly. Yes, ask the people about the budget and they will say it should be balanced, but they do not believe severe measures are necessary to do so. In any event, (to cite what Amatai Etzioni called his "threepenny interpretation" of the public-opinion polls), they do not want to make budget changes that hurt. This is particularly true on the spending side, where the majority would prefer to have taxes raised rather than see social programs cut back—especially transfer payments to the middle class, which is where the big money is. On the tax side, the Forum members anticipate only some trimming of loopholes, including probably a minimum tax on corporations, but nothing in the way of big revenue increases. Some day we will have a crisis that will force the President and Congress to make the politically painful decisions needed to close the budget deficit—but not now.

Tax simplification and reform—that is, reform without raising revenues—is also a dead issue. Now that the Treasury proposal is on the table, along with Bradley-Gephardt and Kemp-Kasten, the modified flat tax may be talked about a lot. But talk is about all that can be expected.

Can it Last?

A budget outlook as pessimistic as suggested here, with massive deficits continuing as far as the eye can see, raises serious questions about the viability of current economic and financial conditions. The report on last Spring's meeting of The Conference Board Forum reached the conclusion that the oversized internal and external deficits together with high interest rates and an overvalued dollar are a combination that, over time, is fundamentally unstable. Indeed, the report was entitled *Unsustainable Trends and Hard Policy Choices* (Research Bulletin No. 162).

Well, the politicians (as is their wont) evaded the hard policy choices. But no crisis developed. The chickens did not come home to roost. They are, in fact, nowhere in sight. Both the economy and inflation are behaving pretty well.



"Yes, I'm somewhat depressed, but seasonally adjusted I'm probably happy enough."

Drawing by Mankoff; © 1984
The New Yorker Magazine, Inc.

In particular, the interest-rate explosion that was to have ignited when growing private credit demands collided with the Treasury's needs did not occur. Why? Because it turned out to be much easier than expected to get savings from abroad.

Were we wrong last Spring to label the situation "unsustainable"? Nothing in the current outlook says we are headed for a crisis. And it still seems true that no place else in the world looks as attractive for investment as the United States. Europe and Japan want trade surpluses. Consequently, savings from abroad continue to be available for the United States to use to finance half or more of its budget deficit. For now, at least, we have no basis for concluding that current conditions are not sustainable.

Sustainable for now, yes, and for 1985, quite probably. But the Forum members seriously doubt this can continue for a long time. None of us feels, in Robert Wade's words, that we can "learn to stop worrying and love the deficit." Over the longer term, the cumulative effects are unavoidable.

At some point, foreigners will lose their appetite for dollars. It has not happened yet, but one day they will decide their portfolios contain enough dollar-dominated assets, and they will stop buying more; maybe they will sell a few. Once that happens, the present seemingly stable balance of forces starts to unravel. The dollar's exchange value will decline, perhaps sharply. After a time, our export industries get relief, but inflation accelerates. And if the available supply of savings is reduced in the process, as seems quite possible, interest rates will rise. A few chickens will have come home to roost.

At home, chronic deficits carry several serious risks. One is the possibility that a recession enlarges the deficit still further and induces hasty and ill-timed measures to raise taxes and cut spending, which in turn exacerbate and prolong the recession. Another is the threat that, following the next recession perhaps, public acceptance of monetary discipline and high interest rates would gradually evaporate, and political pressure from elected officials would force the Federal Reserve to monetize the deficit, which would set off a serious new conflagration of inflation. A third risk is that long-term growth is slowed to a crawl either by widespread protectionism or by inadequate capital formation. Already we have seen, as James Tobin pointed out, that more than all the increase in economic activity from 1981 to 1984 was absorbed by consumption and government purchases. If continued, it would not be too many years before the absence of net new investment would starve out the sources of productivity growth.

None of these possibilities suggests a crisis in the sense of a cataclysmic event. A crisis could develop at any time, but it seems more likely that the economic troubles we reap from the current unstable mix of conditions will evolve gradually in what will appear to be a nonthreatening way. The chickens come home to roost, yes, but they drift back one by one, rather than the whole flock coming at once. And the nonthreatening nature of the process could prevent an effective policy response, which would be unfortunate. No matter how inconspicuously a longer recession or higher inflation or slower growth sneaks up on us, the impact is just as grave. A crisis could well be preferable, if it would evoke appropriate policy changes.

Concluding Comment

Was all of our discussion of the economic and financial outlook as gloomy as these last few paragraphs? No, not all. The overall tone was on the pessimistic side, perhaps, but not severely so (like the character in the cartoon). The attitude seemed to be that we have been through much of this before and did not enjoy it—nevertheless we did live through it without crisis. We expect the same for 1985, no crisis but no comfort either. And the discussion ended on a positive note when Robert Wade suggested the financial markets may have discounted much or all of the economic troubles that lie ahead. "Both stocks and bonds," he said, "offer reasonable returns over the next several years."

Reading the Public's Mind

Amatai Etzioni

The public entered the 1984 elections rather happy. People felt things were looking up for the economy, for the country, and for themselves. They rewarded the President, who at least presided over the celebration, and quite handsomely.

Meanwhile an age of reconstruction began in many social institutions. After declining in the 1960's, educational achievement (SAT) scores are beginning to rise. After twenty years of rapidly rising divorce rates, the dismembering of the American nuclear family leveled off in the early 1980's. *Both* major political parties dedicated their 1984 conventions to the family, social values and country. Patriotism is in; ROTC, even CIA recruiters, are back on the campus. Crime is down. Participation is up in all religious groups.

All this could cause a terrible societal hangover and worse, if the economy again falls into a considerable recession, unemployment rises, and/or inflation reignites.

In politics, attention focuses at the moment on the Democratic party shambles, and its sure-to-be-continued propensity for fratricide. Within the GOP, one should not disregard the movement to the right (remember Dallas 1984). A November, 1984 Gallup Poll found that the proportion of Americans who see themselves as "right of center" rose to a surprisingly high 37 percent. Thus, if things go sour in the country, a somewhat additional tilt in this direction is as likely, or more so, than a return of the pendulum to the liberal left.

Amatai Etzioni

The flat tax has little public support.

The Budget Issue

The public abstractly supports a flat tax and deficit reductions, but these readings of the public's mind are based on counting noses, not measuring the *strength* of feelings. Also, these questions ask for no sacrifices or "trade-offs." Once these factors are taken into account, it turns out that the public (1) is strongly *opposed* to closing most tax loopholes and (2) is unwilling to support major cuts in social programs *or* defense for the sake of deficit cutting.

It would follow that the flat tax, at least one without *many* exceptions, has little public support. Deficit reductions, especially via some "revenue raising" and "non-Draconian" cuts in spending, seem more plausible.

Sawtooth Pattern Ahead

Lawrence Chimerine

After a strong first half, the economy has essentially been flat since early Summer. Little or no increase, or even a small decline, for fourth-quarter GNP now seems likely, following the relatively small rise in the third quarter. This dramatic slowdown is the result of several factors that have now become less stimulative: (1) A substantial portion of the pent-up demand for new homes, appliances and other household durables, which was created during the previous back-to-back recessions, has now been satisfied. (2) Inventory investment has passed its peak. (3) The favorable effect of accelerated depreciation and other tax incentives on the growth of investment spending is tapering off. (4) Fiscal stimulus is declining.

In addition, the negative effects of a severely overvalued dollar are now beginning to outweigh the positive impact of lower inflation, and the increase in interest rates earlier this year, on top of already high levels, is having a more adverse effect on demand than earlier in the recovery.

Lawrence Chimerine

Most of the risks are on the downside.

A Recession In 1985?

Despite the speed with which the softness is accumulating and spreading, some pickup in economic activity is likely to begin during the next several months, reflecting: the declines in interest rates now taking place; the acceleration of military expenditures already under way; continued increases in spending by many state and local governments for road repair, maintenance and other public works; the likelihood that the inventory correction will not be too severe in view of still relatively low inventory/sales ratios in most industries; increased production in auto and related industries now that the GM strike has been settled; and still relatively low inflation (especially with the favorable outlook for food prices), high confidence levels, relatively low debt burdens, and adequate savings, which should combine to produce a rebound in consumer spending.

The magnitude of the pickup will be relatively modest, however, with increases in real GNP averaging no more than 3 to 3.5 percent during the first three quarters of 1985. New housing activity will remain below the levels of early 1984 because mortgage rates will still be well above historical levels, especially since initial rates on adjustable rate mortgages are not being as heavily discounted; and because a large supply of housing now exists, as reflected by the large amount of unsold new and existing homes on the market, and by rising vacancy rates for apartments and condominiums in many areas. The increase in consumer spending will be modest in view of the slower growth in wage and salary income. The increase in capital spending during 1985 will be far less than earlier in the recovery, reflecting the squeeze on profit margins being caused by the effects of the overvalued dollar and slower growth in productivity, the petering out of the impact of accelerated depreciation, and still high real interest rates. Even after the inventory liquidation process now under way is completed, inventory investment will contribute very little to economic growth. Net exports will continue to worsen during 1985 in response to the previous strengthening of the dollar.

Deficits and the Outlook

More moderate economic growth and an acceleration in military spending will cause the federal deficit in the current fiscal year to exceed the $195 billion experienced in FY 1983, following the marginal decline last year. Thereafter, these same factors, plus increases in the cost of many entitlements programs and rapidly rising interest expense, will combine to produce additional deficit increases in the absence of large new spending cuts or tax increases. These factors cannot be offset by strong economic growth—a significant decline in future deficits (on a current services basis) would require an average of nearly 5.5 percent per year real growth (implying 4 percent or more annual increases in productivity and/or unemployment below 3 percent by the end of the decade) and additional sharp declines in interest rates. However, historical patterns and recent trends make this extremely unlikely. Although some small spending cuts and/or tax increases might be passed next year, their impact on future deficits will be small relative to the total that is needed to alter the expected trend significantly.

While the better inflation outlook has caused some permanent improvement in the outlook for interest rates, even a modest pickup in economic activity will likely cause rates to start rising again in early 1985. The pressure for rising rates will also reflect the following. (1) Total credit demands and total debt outstanding continue to rise quite rapidly, despite the slowdown in mortgage and consumer installment borrowing. This in part reflects rising borrowing by the corporate sector in response to a widening gap between capital spending and the availability of internal funds. Private credit demands will rise further as the economy rebounds. (2) Money growth has temporarily lagged behind the growth in the monetary base in recent months because of seasonal adjustment and other technical factors (furthermore, the growth in reserves is now accelerating). Thus, it is likely that the money supply will grow more rapidly during the next few months. (3) Treasury borrowing will be enormous during the first half of 1985, and is likely to continue to rise thereafter. (4) Foreign purchases of U.S. financial assets are likely to slow from the recent pace. Thus, we expect most interest rates to rise by nearly 200 basis points from early 1985 through late Summer or early Autumn. This is likely to produce another sharp deceleration in economic activity in late 1985 and the first half of 1986, with the economy again flattening out during that period.

Thus, the period from mid-1984 through 1986 will be characterized by a sawtooth pattern, with periods of slowdown (which bring interest rates down) followed by some acceleration in economic activity (which will push rates up again). This implies relatively slow average growth. Furthermore, most of the risks are on the downside—in the near term, a sharper slowdown (or recession) will occur if inventories are reduced more sharply than now expected, or if consumer confidence deteriorates rapidly. Thereafter, the major risks to the forecast are that of a sharp decline in the dollar prior to actions to reduce Federal deficits (pushing up interest rates more rapidly than now projected), or that the adverse effects of large budget and trade deficits and a rising Federal debt/GNP ratio are even sharper than now expected.

Consumer and Housing Outlook

Allen Sinai

Allen Sinai

Increased spending on automobile and homes.

The U.S. economy appears to be in a growth recession, with a one-in-four chance of something worse developing. Little growth is occurring so far in the fourth quarter, particularly in the consumer sector. Weak spending on consumer durable goods and a sharp decline in net exports have reduced domestic sales, orders and profits, leading to a mild inventory cycle. Some paring back of capital outlays, attempts to reduce inventories, and caution on employment can be expected into early 1985. Although the classic signs of an impending recession are not present, the eventual playing out of these forces does not rule out such an eventuality.

For 1985, the most likely pattern for consumption is increased spending on interest-sensitive items such as automobiles and homes, as loan rates finally drop sufficiently to induce increased activity. Despite large declines of short- and long-term market-interest rates, mortgages and loan rate reductions have been substantially less. In addition, incentives to save and disincentives to borrow and spend in the form of extraordinarily high real and real-aftertax returns on saving and costs of borrowing seem to be encouraging a shift to saving from spending. (See table.) Given that the effects of the personal income-tax cuts of 1981-1983 are now waning and that a large portion of the pent-up demand by households for big-ticket items has been satisfied, growth in real consumption can be expected to be only 2.8 percent, compared with the 4.8 percent and 5.2 percent surge in 1983 and 1984. Housing outlays should also reflect a diminished propensity to consume, with starts at 1.55 million units next year, compared to the 1.77 million units of 1984. Underlying these expectations for consumer outlays is a reversal in the current downtrend of interest rates during the second and third quarters of next year, stemming from: (1) no resolution of the policy mix difficulties that have created the current slowdown; (2) sufficient reacceleration in economic growth to raise sharply the demand for money; (3) a still-huge volume of Treasury financing superimposed on renewed growth in private-sector credit demands; and (4) the discipline of the lower monetary-growth targets set for 1985 by the Federal Reserve.

Consumer Outlook

What the consumer giveth, the consumer can take away. After six quarters of strong spending and weak saving, especially on big-ticket items such as autos, houses, furniture, appliances and other durable goods, households finally cut

Nominal, Real, and Real Aftertax Interest Rates: Before and After the New Federal Reserve Policy (Averages for Period Indicated, Percent)

	Nominal			Real			Real Aftertax		
	1955-79:3	1979:4-84:3	1984:3	1955-79:3	1979:4 84:3	1984:3	1955-79:3	1979:4-84:3	1984:3
3-Month T-Bill Rate	4.6	11.0	10.3	0.2	5.4	11.0	–0.3	3.9	9.8
Mortgage Rate	7.2	15.0	15.0	0.4*	6.6	10.2	–0.6*	4.5	8.3
Prime Rate	6.0	14.6	13.0	1.9	9.6	12.6	–0.6	4.3	7.6
New Issues, Top Quality Loan Rate	6.2	13.1	12.5	2.8	5.4	7.4	2.0	3.6	5.8
24-Month Consumer Loan Rate	9.3	17.0	16.8	5.4	8.4	13.4	4.0	5.3	10.5
36-Month Automobile Installment Rate[1]	9.1	15.0	14.1	6.2	8.4	11.4	4.4	5.7	9.0

*1965-79:3.

[1] 1957-79:3.

back in mid-1984. The reductions in consumption were concentrated in durable goods spending which, in real terms, was hardly different in October from January, 1984.

For the next year, consumption spending should continue to grow, particularly in the second and third quarters of 1985, but at a much slower pace, especially for durable goods. Nondurable goods spending and services spending should keep rising at a good clip. About a 1 percent rise in consumer durable outlays, in real terms, can be expected. Services outlays should be up some 3.5 to 4 percent. The personal savings rate should remain relatively high, by recent standards, at near 6.5 percent.

The main reasons for the renewed growth in consumer spending expected for 1985 are the lagged reactions to lower interest rates in 1984, a small tax cut from indexing, and improving balance-sheet positions as an outgrowth of the recent pause in spending and borrowing. Household incomes, net worth, and consumer financial positions remain basically sound, although not so strong as in recent years. Sentiment will worsen somewhat in the near term, but pick up as the economy moves through 1985. The key factors underlying this forecast include:

- Real disposable income: up 3.3 percent over the next year after the 6.7 percent rise of 1984. A small cut in taxes from indexing, about $7 billion, will help raise real disposable income in the first half of 1985; but growth will be much less than in 1983 and 1984.
- Sentiment: becoming more pessimistic at year-end with a rise in the unemployment rate and weak equity markets, but improving in 1985 as economic growth responds to an easier monetary policy.
- Loan rates: down another one-half to one percentage point for mortgages and consumer loans, helping to raise consumption by late in the first quarter of 1985. So far, loan rates have hardly responded to the large declines of market interest rates in recent months, so that buying financed by borrowing is not likely to turn up quickly.
- Consumer net worth: in real terms, a good but lesser rise of 4.8 percent in 1985, compared to 13 percent in 1983 and 6.3 percent this year.
- Household balance sheets and financial position: adequate, but the taking on of a considerable amount of debt during the period from second quarter 1983 to second quarter 1984 in order to finance durable goods will have some continuing negative feedback effects.

Housing

New-home sales and housing starts can be expected to respond to the downs and ups of interest rates. Housing starts are projected to fluctuate between 1.5 and 1.7 million units over the next year. Deposit inflows to lending institutions and mortgage finance should be ample, especially with the improved secondary market in mortgage finance. Heavy use of adjustable-rate mortgages will continue to make housing affordable for many American families.

Longer run, another pause in growth and lower interest rates in 1986 should establish a better base for stronger growth in consumption and housing later in 1986 and 1987. The major risk to this outlook is the possibility of sharply higher interest rates for 1985 or 1986, over a clash on the budget and/or uncertainty about Federal Reserve policy. Resolution of the policy mix problem in an obviously credible way, with a tightening of the budget followed by easier monetary policy, could drastically change the outlook for interest rates for consumer and housing expenditures. A shift toward a tighter budget and easier monetary policy that was clearly set to occur would lower interest rates substantially and reverse any weakness in consumption and housing. Another major downside risk lies in current tax reform legislation as it pertains to aggregate consumption, that is, risk of a negative effect on home prices and consumer outlays through increased incentives to save and the impact on household net worth.

Keynesian Shock II

Albert T. Sommers

Albert T. Sommers

The Fed is again an ally of growth.

The subsiding of U.S. growth from its enormously energetic level of the first half of the year was so widespread in the third quarter as to be obvious to all, including the Federal Reserve. It was visible not only in the sharp decline of real growth that now appears in the national accounts of the third quarter but also in all of the basic data on sales, orders and backlogs, in inventory policy, in the acceleration of delivery rates, in corporate profits, and in the renewed widening of the federal deficit. The crucial and culminating statistic in this emerging description of weakness was almost certainly the flash report on new orders in durables industries for October, which revealed a broad and general decline, including a sharp decline in capital goods orders in nondefense industries.

Most strikingly of all, the enormous decline in interest rates of the past several months has brought them to levels not anticipated in most models until fully six months from now. Most of the decline in rates occurred without visible assistance from the Federal Reserve; the monetary base, over which the Federal Reserve has substantial control, has risen at only about a 2-percent annual rate for the past months, and M_1, over which it has considerable influence, has experienced no growth at all. The most powerful reason for the decline in rates has been the continuing reappraisal of the inflation outlook, which was helped along largely by the stability of the price indexes themselves—a consequence of the ferocious competition with imports—together with a big assist from the weakness in petroleum prices.

The Federal Reserve is thus in about the position it might have expected to encounter in the Spring of 1985, and its latitude for action is now clearly enlarged. However much it must resent the fact that its efforts to restore growth to the system before any action is taken on the federal deficit will look like "monetization," because it will revive acquisitions of government securities by the banking system, the resulting outcries from pure monetarists will have to be ignored for a while. The more proximate danger is that even sluggish growth on the part of the U.S. economy would act to enlarge the federal deficit (as it is already doing), while at the same time it would reduce the likelihood of action by the Administration and the Congress to curtail expenditures and raise taxes.

The business weakness has removed the Federal Reserve's range of restrictive options; it is in a position to administer what might be called "Keynesian Shock II"—liberal provision of reserves, leading to at least moderately rapid growth in the money stock, in the presence of a very large budget deficit. Keynesian Shock I, of course, occurred in the Fall of 1982, in absolutely immense degree, and was responsible for the awesome rate of economic recovery that ran from early 1983 into the middle of 1984. The Federal Reserve, at least temporarily freed from its inflation concerns by the stability of prices and by the apparent weakness of U.S. markets, is again inevitably an ally of growth. Even in the presence of the budget deficit (however bewildering it is to find weakness in the presence of such a deficit) its behavior for the next six months will be seeking a recovery in U.S. markets, and *then* controlling it when it occurs.

The conditions under which Keynesian Shock II will be applied are different from, and more cautionary than, the conditions that applied in the Fall of 1982; the application, and the outcome, and the duration, are all likely to be more moderate. This time around, there are some big actual differences in the situation, as well as putative differences in the probable consequences. For one thing, business inventories have been accumulating rapidly, whereas they were in gross liquidation at the time of Keynesian Shock I. The whole system is much nearer high employment, and the budget deficit, while it is smaller in dollars than it was in late 1982, is now almost totally *structural* rather than *cyclical*. The aggregate rate of debt incurrence by nonfinancial sectors is already positive, as contrasted with sharp negative change in the Fall of 1982. Operating rates in business are at 82 percent of capacity, not 68 percent. In Shock I, the system was still generating volumes of deferred demand; this time around, the cyclical phase of the system has been at high levels for a year, as it recouped the demands deferred out of 1981-1982. Shock I had to turn the whole system from deep recession to expansion; Shock II simply has to reinvigorate a system that has consumed a good deal, but not all, of its natural cyclical opportunities. And, finally, and most problematically of all, the dollar is fully 25 percent higher than in the Fall of 1982; the trade deficit is six times greater, the deficit on current account is also about six times greater. Nobody, but nobody, knows the true size and direction of the capital inflows that necessarily accompany the current account deficit, or their ultimate sensitivity to declining U.S. interest rates. But the spectacular imbalance in the

U.S. international account would certainly seem to limit the opportunities for expansionary policy at home.

Under these circumstances, what does the Federal Reserve do, and what are likely to be the consequences of its actions? The very sharp declines in interest rates from their peak in July—now covering the discount rate and the prime rate, as well as virtually all market interest rates—has been virtually entirely a consequence of market conditions, not of Federal Reserve action. They are traceable to the rapid decline of the U.S. economy into an uneasy and suggestive pause; and to a precipitous decline in the perceived present and probable future rate of inflation. Such paradoxical developments—the slowing of growth, the low inflation, the comfort in capital markets in the presence of a gigantic budget deficit—are all consequences of the U.S. international position, which has provided a flood of imports to brake industrial growth and severely restrain inflation, while providing the capital-market inflows required to keep peace in financial markets even in the presence of the budget deficit. It is a reasonable conclusion that the Federal Reserve has a range of options capable of generating a modest-sized Keynesian Shock II and that it will take that opportunity now.

Challenges to Policy

James Tobin

Two difficult challenges confront macroeconomic policy in 1985. The immediate challenge is to keep the recovery going; this is the task of the Federal Reserve. The longer-run challenge, to the Administration and Congress as well as the Fed, is to shift the policy mix to a much tighter budget and an easier monetary stance, lowering interest rates and the foreign exchange value of the dollar.

The Fed has succeeded in slowing the recovery. Volcker & Co. so wanted a soft landing that they may be bringing us down short of the runway. As unemployment and excess capacity reports show, the economy is still slack. Inflation is quiescent, and the monetary aggregates barely exceed the lower limits of the Fed's target ranges. The Fed appears to be cautiously exploiting the opportunity to ease. Its task is not just to avoid outright recession but to overcome the incipient growth recession. This is a delicate operation; the degree and speed of monetary easing will be tempered by the Fed's chronic worries about inflation and its fears of a disorderly fall in the dollar. The greater risk is that the Fed will be too cautious and too sensitive to less favorable news from price indexes and exchange markets.

The coming year is the ideal time for the President and Congress to take actions to arrest the runaway growth of federal debt relative to GNP, to take actions that would take effect in 1986 and later years. Such legislation would help the Fed meet its immediate challenge; interest rate reductions in 1985 would be more effective because they could be expected to be permanent. But it seems unlikely that fiscal corrections will be adopted next year. During the 1984 electoral campaign the President committed himself strongly against tax increases and other measures without which little reduction in prospective deficits is arithmetically possible. He remains wedded, it seems, to the strategy of using budget deficits as a weapon for cutting civilian social spending still further, a strategy the Congress is bound to oppose.

James Tobin

1985 is a critical year for policy.

Should the economy slip into recession despite Federal Reserve efforts to the contrary, projections of deficits and debt will become frighteningly larger. Not only will anti-recessionary fiscal measures be unthinkable, but ill-timed and counterproductive fiscal restrictions may be voted in panic. This is another reason why 1985 is a critical year for policy.

On the LDC's, Banks and Ulcers

David T. Devlin

Most of my time the past few years has been spent thinking about the less-developed countries (LDC's) and whether or not they and the banks are going to go broke. In the process I have had to assume some kind of world economic environment in which they operate. My current prejudices follow:

	U.S.		Seven Major Countries	
	1984	1985	1984	1985
Real Growth, percent	6	3	5	3
Inflation, percent	4	5	4	4
Current accounts, $ bill.	-85	-100	-33	-40

In real terms, both U.S. interest rates and the value of the dollar have been too high for too long for my theoretical (mostly monetarist, but pragmatic) taste.

I was impressed over the last few years by both the Republicans and the Democrats being in favor of reducing the budget deficit. And I believe they were sincere. As I said before the election, I hope one of them wins and reduces the deficit. But which is it to be: increased taxes, reduced military spending (Democrats) or reduced "entitlement" programs and a boost from growth (Republicans)? There was a deadlock and less of one, but still one, continues. I bet even money on a reduction of some $50 billion by 1987.

Now let's turn to the U.S. balance of payments. Last century Bank of England observers reportedly said that 1 percent on the bank rate brings money from the moon. The United States has demonstrated they were not kidding. In 1984, our budget deficit is $170 billion; our current-account deficit is $85 billion. Some 50 percent of the net budget deficit is financed from abroad. If you look at gross inflows, it's more. Developed countries like the United States are supposed to be capital exporters. Something is funny, but I expect and hope it's only temporary.

Now, what can be said about the banks and less-developed countries? The LDC debt crisis reflected two factors: the horrific world economic environment of 1980-1982, and inadequate adjustment, at least initially, by the developing countries to that environment. As a result, some 32 countries rescheduled debt over the last few years, some a number of times. It was almost inevitably done in the context of an IMF program that required the country to adjust, and as part of which the lending banks put up some new money, mostly nonvoluntarily. Today, the world economic environment has turned around: OPEC has gone into deficit, and the current-account deficits of non-oil LDC's have dropped from $110 billion in 1981 to some $45 billion now. Thus, they *are* adjusting.

David T. Devlin

The LDC's are adjusting.

How about the future? Both the world environment and the adjustment process look OK for 1985. In 1986-1987, a "wall" of amortization is approaching. However, if a country is adjusting, a multiyear rescheduling can magically flatten the wall, as in Mexico for example. Keep in mind the fact that no one—not the LDC's, corporations or the U.S. Treasury—is expected to actually pay off its debt, only to keep it from rising at a more than sufficiently modest pace.

Along with the revival of growth in the major industrial countries and the impact on commodity prices and imports, economic growth is now recovering in the developing countries. There is always a lag in the perception of a turnaround, but even then the political-social tensions in the LDC's appear manageable.

There are still major problems: Countries that either don't have a functioning IMF plan and need it, or absent which there are doubts about whether they will continue to follow it. Although many bankers and officials will continue to get ulcers over these countries, the systemic threat to the international monetary system has been contained, at least for now.

What is not assured is longer term development and the structural adjustment required in the LDC's, if they are to increase real per capita GNP in the long run. If the fiscal-monetary-exchange-rate policies necessary to manage their liquidity are appropriate—well, that is a necessary condition for development but not a sufficient condition. Countries can be perfectly solvent and creditworthy, and have quite inadequate development.

For development, a whole range of other policies comes into play: Internal price incentives so producers have an incentive to produce; removal of various internal, administrative distortions; incentives for domestic saving and for foreign direct investment. There is lots to be done here. Perhaps if some combination of the World Bank, official agencies, country officials, and the banks could develop an adequate monitoring of this process, the world community could work out a way to get the funds moving that are necessary to finance such development.

Inflation and The Budget

Barry Bosworth

The inflation outlook for 1985 is extremely optimistic. No threat of acceleration exists in the United States. Labor markets are weak and wage-increases are, if anything, still softening a bit. Nothing in the economic outlook expressed here would change these prospects. The same can be said for food and energy prices, which are likely to remain quiescent. Thus I expect inflation to hold in the 4 to 5 percent neighborhood through 1985.

An interesting implication of the current forecasts for slower economic growth in 1985 is that it probably reduces the prospects for significant actions to reduce the federal budget deficit. While we are used to thinking of the economy as depending importantly upon the governments' fiscal policy, legislative budget actions today have themselves become dependent upon the course of the economy. The reason is that the public discussion of budget issues in recent years makes clear that no significant deficit reductions can be agreed upon short of a major economic crisis. Such a crisis would force the President and the Congress to compromise their differences and undertake a package of both tax increases *and* expenditure reductions. Short of such a crisis, much as Americans dislike budget deficits, they are more opposed to the sacrifices that would be required to resolve the deficit problem.

In prior years many economic forecasts projected that the budget deficits would ultimately generate just such a crisis. The government deficit continues to absorb well over half of net private saving. That was expected to curtail sharply resources for private investment. That was also expected to force very high interest rates or, if the Federal Reserve attempted to avoid the financial crisis of much higher rates by expanding the supply of credit, accelerating inflation. But neither higher interest rates nor inflation appear in the forecast for 1985. The basic reason is that it has proved far easier than anticipated to finance both the budget deficit and a high level of domestic investment. The magnitude of the net borrowing from foreigners, the current account deficit, now exceeds $100 billion annually or 3 percent of total national output.

Barry Bosworth

No significant budget action without crisis.

The outlook for 1985 is that, while the budget deficit will not decline, it will not increase as a share of GNP, and surveys of investment plans indicate a slowing of the investment boom. Thus, there is no increased pressure on the financial markets and the current situation can be sustained as long as the United States can borrow about 3 percent of GNP overseas—a trade deficit no larger than in 1984.

In fact, it appears that this balance could be maintained in 1985 and allow interest rates to decline. Lower interest rates in the United States may not put downward pressure on the exchange value of the dollar because European countries, desperate to join in the recovery, are likely to match any U.S. interest rate decline to stimulate their own economies. In addition, Europe is increasingly dependent on a large U.S. trade deficit to support its efforts to achieve an export-led recovery. Finally, the rapid deterioration of the U.S. trade deficit implies that the exchange rate is higher than necessary to balance saving and investment. A small decline of the exchange rate would still imply a sufficiently large trade deficit. Thus our economic forecast should lead us to reduce our expectations of significant budget actions.

Capital Market Outlook: Uncertain and Unstable

Daniel S. Ahearn

The recent slowing of the economy, still subdued inflation pressures, and an easier Federal Reserve monetary policy have improved the tone of the capital markets. Equity prices have risen modestly from summer lows, bond prices are significantly higher, mortgage interest rates lower. But the markets now face a confusing variety of challenges that suggest great uncertainty at best and the possibility of significant decline or even crisis at worst.

Where the capital markets go from here depends on five related factors: First, whether the economy recovers from its current sluggishness or weakens further into recession. Second, whether government makes progress in correcting the two great threats of unprecedented deficits in the federal budget and in the U.S. international trade account. Third, what happens to the dollar. Fourth, whether inflation remains subdued. And fifth, what happens to the tax reform proposals which threaten to change some of the most important elements of the framework of the capital markets.

There are grounds for optimism on the near-term economic outlook. The current slowdown is typical at this stage of an expansion and the normal subsequent reacceleration should be helped this time by a rebound from the two auto strikes at GM. Most importantly, government policy has become more expansive. Monetary policy has eased significantly at the same time the budget deficit has begun to rise more rapidly. Capital goods orders may be accelerated to hedge against possible loss of the investment tax credit. All this should permit an early end to inventory reduction efforts and offset much of the drain of U.S. buying power into imports.

Unfortunately, the outlook for correcting the massive deficits in the budget and U.S. trade account is not positive. The presidential campaign left a legacy of commitments that is negative for the federal budget. Mr. Reagan ruled out tax increases, any slowdown in defense spending and reduction in social security benefits, leaving only 30 percent of the budget to be cut. But Congress feels that nondefense and nonentitlement programs have already been cut severely. Thus, the odds favor little progress on controversial legislation, including the tax reform being advanced by the Reagan Administration. Moreover, regardless of how much actual change eventually occurs, the capital markets will be buffeted by hopes and fears as to what might be changed in the tax framework. Meanwhile, high budget deficits are likely to continue unless action is forced by some kind of crisis.

Budget deficits that add to the demand for funds and tend to raise interest rates are a major negative for the capital markets. They also risk serious longer run trouble by diverting too much of the U.S. savings flow from private investment, the source of economic growth and cost reducing productivity gains. Continued large budget deficits would likely make the economy both sluggish and inflationary. They would also encourage continued large imports of foreign goods, implying that our record trade deficit would likely persist or increase.

Daniel S. Ahearn

An ever present risk of crisis in the markets.

Whether the dollar would remain strong in this context is doubtful. Currently, sentiment toward the dollar is positive, despite an overload of dollars in the world's currency portfolios. But it would seem only a matter of time until the roughly $150 billion a year outflow in prospect for 1985 and later as a result of the trade deficit overburdens the willingness of foreigners to hold dollars and undermines the current positive psychology. Reliance on a continued positive psychology to keep the dollar strong is risky.

A weaker dollar could have sizable consequences. For one thing, the strong dollar has had a major effect in holding down inflation. It is estimated that each 10 percent rise in the dollar has reduced the U.S. rate of inflation by 3/4 to 1-3/4 percent. If the dollar should weaken, the U.S. inflation rate will worsen accordingly.

Moreover, foreign financing of our credit and capital markets has amounted to 2 to 3 percent of U.S. GNP and 15 to 20 percent of gross U.S. investment. The impact on interest rates of a lessened willingness of foreigners to supply funds could be important. Outright disorder in the currency and capital markets could develop if foreign investors try to reduce or eliminate their dollar holdings too quickly. While the Federal Reserve might supply funds to offset such currency shifts, official support operations could conceivably worsen the problem by raising fears of further inflation.

All this suggests a highly uncertain and unstable capital-market outlook. The economy should be rising but in 1985, fears of recession in 1986 might well rise. Inflation will remain moderate but on a gently rising trend with vulnerability to acceleration. Continued high budget and trade deficits will challenge the capital markets and inhibit the economy's performance. The current strength of the dollar may be succeeded by increasing instability with a downward bias. There will be an ever present risk of some kind of crisis in the capital and/or exchange markets and at some point, difficult to time, this risk probably will become actuality.

Equities: Moderately Undervalued But Not Compelling

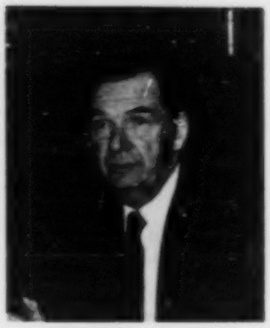
Robert G. Wade, Jr.

Interest rates have fallen significantly. This has somewhat reduced the attraction of bonds and money market instruments vis-a-vis equities, a plus for the stock market. Just as important for equity market prospects, the lower rates, while symptoms of a currently weak economy, should be a factor leading to stronger economic growth later.

Interest rate drops of the magnitude witnessed since May have historically always been bullish for equities (absent a depression). For example, Federal Reserve discount rate cuts, which are a non-event in that they generally follow rather than lead rates, do confirm that the economy is weak and/or the Fed is easing policy. Such an environment leads to rebuilding of liquidity and is a favorable sign for stocks. The accompanying table demonstrates the bullish significance of initial discount rate cuts.

While economic growth may be below par for a couple of quarters, we do not expect a recession. The Fed has not had to worry about inflation, which has allowed it to ease more quickly at signs of an economic pause. Economic growth should move back to approximately trend levels next year, in the Spring or even sooner. The equity market would typically begin discounting the improved situation well in advance of the event. Over the shorter term, lower economic growth could give investors concern about corporate profits, but the lesson of history is that the favorable implications of lower interest rates win out over such concerns.

There is a decent probability of recession in 1986. Monetary policy should tighten later on in 1985, if the economy does get back on track. If a recession has to occur, the administration may prefer 1986 to a date approaching the 1988 presidential election.



Robert G. Wade, Jr.

Both stocks and bonds will provide attractive returns.

Initial Cuts[1] in Federal Reserve Discount Rate and Subsequent Equity Market Returns 1951-1984

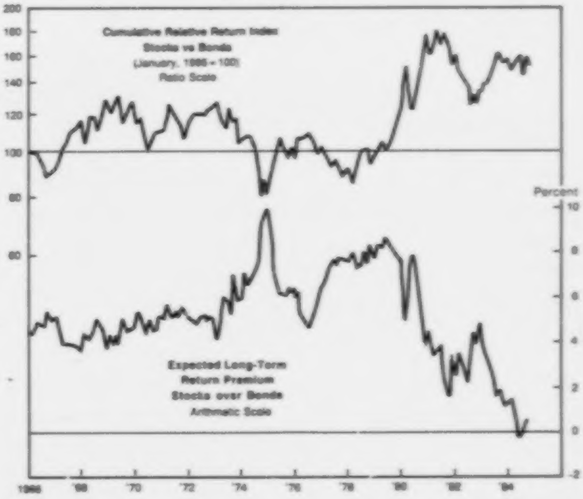
Month of Reduction	Total Returns of S&P 500 over subsequent periods		
	3 mos.	6 mos.	12 mos.
July 1953	0.5%	8.6%	31.9%
Nov. 1957	(1.1)	7.8	30.8
June 1960	7.5	8.1	13.5
Apr. 1967	1.6	1.4	7.2
Nov. 1970	11.8	16.0	11.2
Nov. 1971	14.2	18.2	27.7
Dec. 1974	22.9	41.8	37.2
May 1980	11.4	29.4	25.0
Sept. 1981	7.0	(0.7)	10.0
Nov. 1984	?	?	?
Average	8.4%	14.5%	21.6%

[1] Initial is defined as the first reduction in the discount rate after a previous increase or increases.

Valuation

Equities are moderately undervalued in an absolute sense. Price/earnings ratios are low, and the earnings are not being distorted by inflation. Compared to bonds, however, equities do not seem compelling, despite the drop in rates which has occurred and the good relative performance of bonds that has resulted. Specifically, our current long-run expected return for equities is about 12½ percent (inflation assumption 5½ percent), which compares with current government bond yields of about 11.3 percent. This 1.2 percent premium, while improved over the negative premium existing a few months ago, is still an historically low number (see chart).

Expected Return Premium
Stocks vs Bonds



Sentiment-Supply-Demand

For the year ending June, 1984, pension funds for apparently the first time have, on a net basis, put no incremental cash flow into equities and, in addition, have sold stocks to buy bonds. This is a longer-term positive for equities as it increases the capacity of pension funds to buy more stocks in the future. However, given the narrow stock-bond premium referred to previously, this potentially bullish factor may not emerge until the apparent incentive to invest in equities is greater.

Speculative interest in the market has waned. For example, equity offerings are averaging $200 million weekly as against $2,000 million 18 months ago. Over-the-counter volume is down sharply. Sustained long-term bull markets have always been born in a similar apathetic atmosphere.

On a shorter-term basis, institutional cash reserve levels are apparently on the low side. Not coincidentally, perhaps, 75 percent of investment advisers are bullish on the equity market. Such "technical" conditions have not produced good equity markets in the past.

In sum, we feel that both stocks and bonds will provide attractive nominal and real returns over the next several years. On a more strategic basis (six to twelve months), the equity market is still vulnerable to correction. Consequently, we will be deploying our current cash reserves into the equity market only on weakness.

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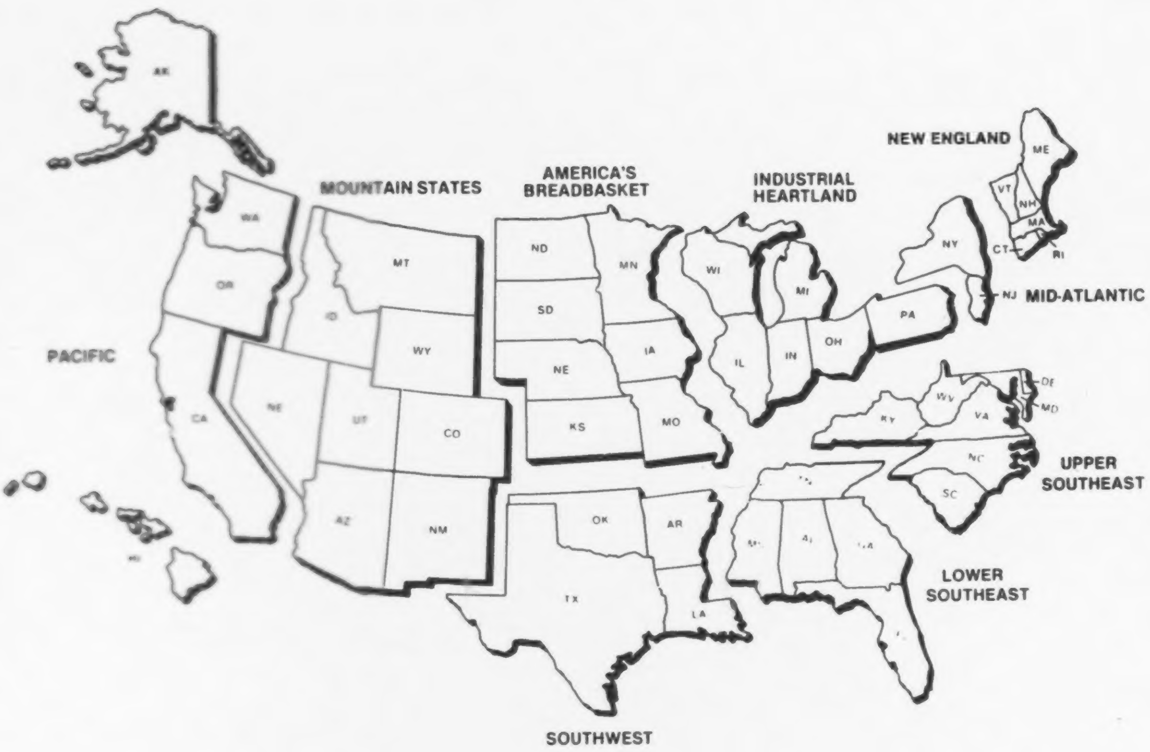
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This report contains brief updates of regional economic developments since the February 1984 meeting of the Conference Board's Regional Economic Forum. The proceedings of that meeting were published as Research Bulletin 161, *U.S. Regional Outlook 1984-1985*. At the time of that meeting, the economic news was unquestionably positive and the Forum members were encouraged. They expected good economic news to predominate in 1984, and that expectation has been met. But they were tentative in their assessment of prospects beyond this year, and that tentativeness persists in these updates. The Forum members have not been surprised by the economic slowdown since midyear and, in general, they do not see it as portending seriously unfavorable economic developments in 1985. But they are suffering the uncertainty and uneasiness that often afflict economic analysts when the economy is shifting gears.

Lora S. Collins
Director-Business Conditions Analysis
December 1984

New England

Lynn E. Browne*
Federal Reserve Bank of Boston

NEW ENGLAND

ME
VT
NH
MA
RI

In the third quarter of 1984, the unemployment rate in New England averaged 4½ percent; the corresponding U.S. rate was 7½ percent. New England's low unemployment rate stems from the region's relatively favorable experience in the 1980 and 1981-1982 recessions. At the trough of the 1981-1982 downturn, in November, 1982, New England's unemployment rate was just under 8 percent, compared to a U.S. rate of close to 11 percent. Since then, both the U.S. rate and the New England rate have fallen by more than 3 percentage points. The persistence of such a large differential is unusual; regional unemployment rates tend to converge following a recession.

Employment growth during the recovery has been slower in New England than in the country as a whole. In the first recovery year, the difference was fairly modest. Stronger growth in the region in nonmanufacturing activities, especially trade, partially offset much weaker growth in manufacturing. Within manufacturing, the difference between the region and the nation was particularly striking in the durable goods sector and was due, in part, to the fact that the auto industry and its suppliers are less important in the region than in the nation. These industries suffered very severe employment losses in the recession but grew vigorously in the first year of recovery.

In 1984, growth has accelerated in New England's durable goods manufacturing industries, but remains below the national rate. The growth in the region is concentrated in electrical and electronic equipment, aircraft and shipbuilding, and nonelectrical machinery, which includes computers. A strong demand for investment goods and rising defense spending have contributed to the employment gains in these industries. Other durable goods industries have not fared as well and employment remains close to recession levels. Traditional metals and machinery industries face stiff foreign competition. New England's instruments industry, which grew very strongly during the 1960's and 1970's, also remains in the doldrums; among the causes are weak export demand and excess capacity in process industry customers.

Nondurable goods industries have grown very slowly in the nation in the past year, and employment has actually fallen slightly in New England. Although printing and several other nondurable industries have expanded in the region, the nondurables sector has been in decline in New England for many years. This trend seems to be continuing.

Nonmanufacturing industries also have grown more slowly in New England than in the nation in 1984, with the result that total nonagricultural employment has grown at substantially less than the national rate. All major nonmanufacturing categories have grown more slowly in the region. However, these figures should be viewed with caution. Such slow employment growth is consistent with the decline in New England's unemployment rate only if the labor force has also grown much more slowly in New England than in the nation. The labor-force statistics do not support this. In 1983, revisions to the employment figures, particularly for nonmanufacturing industries, showed New England to have grown much more strongly than the original numbers indicated. Perhaps the 1984 New

Table 1: Percent Changes in Nonfarm Employment since Recession Trough—United States and New England

	Total	*Manufacturing*	*Durable Goods*	*Nondurable Goods*	*Non-manufacturing*
Recovery 11/82-9/84					
United States	6.8	8.5	11.7	4.0	6.3
New England	4.8	3.6	4.9	1.1	5.2
Connecticut	4.6	2.0	1.6	3.0	5.7
Maine	4.8	-0.9	2.4	-4.4	6.8
Massachusetts	4.2	3.7	5.4	0.0	4.5
New Hampshire	9.4	13.9	18.8	7.7	7.7
Rhode Island	4.7	6.1	6.4	5.6	4.0
Vermont	3.9	2.1	2.9	0.0	5.2
Year One 11/82-11/83					
United States	3.4	5.2	6.9	3.0	2.9
New England	2.8	1.7	1.7	1.9	3.1
Year Two 11/83-9/84					
United States	3.3	3.1	4.6	0.9	3.3
New England	2.0	1.9	3.2	-0.8	2.0

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*The views expressed are those of the author and do not necessarily represent those of the Federal Reserve Bank of Boston or the Federal Reserve System.

England employment numbers will also be revised upward. Certainly the Conference Board's Index of Help-Wanted Advertising suggests a healthy demand for labor in New England. The index has increased more sharply in New England in the past year than in the nation.

If the national recovery continues, the short-term outlook for New England is very favorable. Unemployment rates have already fallen to levels commonly associated with full employment. Wages are rising relative to those elsewhere. Despite the sluggish growth in manufacturing employment, average hourly earnings of manufacturing production workers have risen 11½ percent in New England in the past two years, compared with 7½ percent in the nation. For the longer term, a continuation of sluggish growth in durable goods manufacturing would be cause for concern. A decline in this sector played a major role in the deterioration in New England's economic position in the early 1970's, while vigorous growth later in the decade and a relatively strong performance in the recent recessions were critical to New England's subsequent revitalization.

"The Industrial Heartland"

Norman Robertson
Mellon Bank

Through the middle of 1984, the Industrial Heartland experienced a sustained and surprisingly vigorous recovery from the severe 1981-1982 recession. Essentially, employment returned to the 1981 level, and the region's unemployment rate reached a low of 9 percent in June. However, the economic pause that has gripped both the regional and national economies in recent months has caused a measurable decline in the East North Central region, and has raised new concerns about the viability of heavy industry in the area.

Thus far in the expansion, Michigan has led the way among heartland states, registering an 11-percent increase in employment since the recession low. And the other states of the region generally show a similar pattern, with job growth ranging from 6 percent in Illinois to 9 percent in Indiana. In Wisconsin, where the recession was relatively mild, the state's 3.4-percent increase in jobs has been enough to reduce unemployment to 7.6 percent—the lowest rate in the Industrial Heartland.

Although the recovery in the East North Central sector has paralleled the expansion of economic activity in the United States, the recession was far more severe at the regional level. As a result, the area remains well below its 1979 employment high, despite seven quarters of sustained upturn. In fact, September's statistics show that the East North Central is the only major region of the United States which has failed to regain the prerecession peak job level.

INDUSTRIAL HEARTLAND
WI
MI
PA
IL
IN
OH

Table 2: Unemployment Rates—October 1984—"Industrial Heartland"

Michigan	10.9%
Ohio	9.5
Illinois	9.4
Pennsylvania	9.0
Indiana	7.8*
Wisconsin	7.6*

*September

At latest count, the number of jobs in the Industrial Heartland stood nearly 500,000 below 1979, underscoring the importance of sustained expansion in the national economy in 1985 if the region is to make further progress toward regaining economic health. However, most recent statistical reports confirm that, for now at least, the U.S. economic expansion has stalled. The recent weakness reflects overbuilding of inventories and further inroads by imports into domestic markets. New orders for durable goods have dropped sharply since April, signaling a period of sluggish manufacturing activity, especially in the key basic industries that drive the economy of these heavily industrialized states.

Notwithstanding the recent loss of forward momentum, the odds now favor reacceleration of economic growth during the months ahead. The period of inventory correction appears to be nearly over, and the significant easing of monetary policy and interest rates in recent months should shortly be reflected in a pickup in the rate of economic activity. On the other hand, the overvalued U.S. dollar has yet to show signs of sustained decline, suggesting that imports of merchandise will continue to soar and that prospects will remain bleak for U.S. producers attempting to compete in foreign markets.

Illustrating this point, production of capital goods has long been a mainstay of the Industrial Heartland region.

Table 3: Recovery in Spending on Capital Goods, Domestic and Imported—Percent Change from Q3-1981 to Q3-1984, in Constant Dollars—"Industrial Heartland"

Total capital spending	24%
Domestic production	2
Imports	87

Table 4: Recovery of Employment in the Nation's Regions*—Change in Employment from Pre-recession Peak to September 1984, in thousands—"Industrial Heartland"

South Atlantic	1,127
West South Central	881
Pacific	754
Mountain	492
New England	329
Middle Atlantic*	146
West North Central	64
East South Central	30
East North Central*	-489

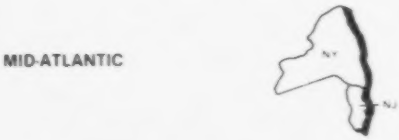
*Regions are as defined by the Census Bureau, except that Pennsylvania is counted in the East North Central rather than Middle Atlantic region. The East North Central states plus Pennsylvania comprise the "Industrial Heartland."

Moreover, until recently the United States has enjoyed a substantial surplus on the balance of trade in the capital goods area. However, the strong dollar has increasingly allowed foreign producers to gain control of U.S. capital goods markets, with the import share rising from 14 percent in the third quarter of 1980 to 26 percent in the third quarter of 1984.

Looked at another way, although the recovery has lifted demand for producers' durable equipment at a rate roughly double the usual pace of post-World War II upturns, U.S. production of business equipment has barely returned to its 1981 high. Meanwhile, the expansion of investment spending in the United States has resulted in a near-doubling of equipment imports during the last seven quarters. And it should be noted that much of the strength in domestic equipment output has been concentrated in the high-tech area which provides relatively little benefit to the Industrial Heartland, while the most serious inroads made by imports have been in the basic capital goods markets that are so important to the region's economic health. In sum, the recovery remains incomplete in the Industrial Heartland. And the prospects for continued improvement in the region's key durable goods industries are clouded by the major problems facing the economy, including the $200-billion federal deficit and the stubborn strength of the U.S. dollar.

The Mid-Atlantic

Thomas J. Spitznas
Chemical Bank



Economic activity in the Mid-Atlantic region, which had been quite strong during the Spring of 1984, cooled off during the Summer and early Fall. The recent slowdown in economic growth in both New York and New Jersey is in line with the slowdown in national growth; there are no signs that a recession in the region is imminent.

Growth in nonagricultural private payroll employment in the Mid-Atlantic region trails national growth by around two percentage points, which is typical for this more mature stage of the business cycle.[1] However, because of relatively slower growth in the New York and New Jersey labor force, the region's unemployment rate is still below the national rate.

The New Jersey economy has been especially strong throughout the current national business-cycle expansion. At 6 percent in October, the New Jersey unemployment rate is well below the 7.4 percent national average. While job growth in New Jersey did not quite match the national pace during 1984, the fact that it came close is surprising, given that the impact of the 1981-1982 recession on New Jersey's economy was mild compared with the impact on the rest of the country. Over the past five years, the New Jersey economy has outperformed the national economy. Since the business-cycle peak in January, 1980, New Jersey private payroll employment has grown around 2½ percentage points faster than national employment.

Retail and wholesale trade have emerged as New Jersey's major growth sectors, while the early pace-setters, finance and services, are now growing at more subdued rates. Growth throughout New Jersey is still somewhat uneven with the Atlantic City area outstripping most other areas by a wide margin, while the Jersey City area continues to lag well behind the rest of the state. A pleasant surprise is the Newark area where employment is growing close to the statewide average.

New York State's economic performance has not been as strong as New Jersey's; however, certain areas within

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[1] Expected upward revisions in New York and New Jersey employment data for 1984 will narrow the growth gap somewhat.

Table 5: Percent Change in Private Payroll Employment—United States and Mid-Atlantic

	1983	1984 (Estimate)	1985 (Forecast)
United States	0.8%	5.3%	3.3%
Mid-Atlantic	1.0	3.2	2.4
New York	0.5	2.7*	2.2
New Jersey	2.2	4.2*	3.0

*Expected to be revised up

the state did extremely well during 1984. New York City, for example, will record the fastest annual growth in private payroll employment since records began to be kept in the early 1950's. Among the New York City suburbs, Long Island (Nassau and Suffolk counties) experienced strong, well-balanced economic growth for the second straight year. Certain of the upstate New York regional economies are also experiencing solid growth. However, given the relative importance of capital goods production in upstate New York, the performance there has been disappointing. In the midst of a national boom in spending by business on capital equipment, it is puzzling that employment in this sector is virtually unchanged in upstate New York and growing only moderately in New Jersey, while national employment in capital goods industries is up over 9 percent for the year. The failure, at least so far, of New York and New Jersey to participate fully in the capital spending boom could be a reflection of a growing inability of the region to compete with imports of foreign capital equipment.

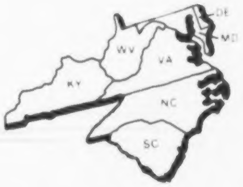
With the national expansion likely to continue through 1985 at a rate close to the 3 percent historical growth trend of real output, the Mid-Atlantic region should experience another year of solid growth in employment. Compared with 1984, average annual employment growth during 1985 will slow in both New Jersey and New York in response to the national slowdown already under way. However, due to the relatively low share of cyclical industries in the New York and New Jersey economies, the expected slowdown will be less pronounced in the Mid-Atlantic region than nationally.

The Upper Southeast

Kemper W. Baker, Jr.*
Federal Reserve Bank of Richmond

The economy of the Upper Southeast has seen a variety of forces at work in 1984. The result has been significant and durable economic improvement, but not without continued change and a few disappointments. As the business investment sector assumed the leadership of the national recovery, the region experienced major gains in related areas, but drew little support from its sizable consumer goods base. Moreover, the heavy drain of the U.S. merchandise trade deficit intensified. Leadership of the regional economic expansion passed to industries and sectors that had little clout in the region only a few years ago. All in all, the region's new directions and strengths have become more apparent, but the forces of transition have dominated over those of growth, and short-term gains in employment and income have suffered.

As 1984 got under way, expansion in the region was being driven by industries related to housing and automobiles—such as the production of textiles, building materials and supplies, and appliances. As the recovery evolved, its direct and indirect effects reached more sectors and areas of the economy.



UPPER SOUTHEAST

In terms of the broad measures of economic activity, the Upper Southeast has not kept pace with the nation. Personal income growth has been only slightly below the national average, but employment growth had fallen well short as of mid-year. Within the region, only South Carolina added jobs faster than the national average. Kentucky, North Carolina, and South Carolina each out-performed the nation in personal income growth, and Delaware could be added to the list if nonfarm income were the measure. The outlook for the region, however, is better than recent performance might suggest.

Employment gains were achieved virtually without help from most of the region's major industries—furniture and fixtures, textile mill products, apparel, lumber and wood products, chemicals and tobacco products. In fact, these six industry groups combined for a net loss of almost 1,500 jobs in the region from July, 1983 through July, 1984. Chemicals, textiles and tobacco actually suffered employment losses over the year. Of the other traditionally important industries in the region, only coal is showing truly outstanding gains in output and employment this year. On

*The views expressed are the author's and do not necessarily reflect those of the Board of Governors of the Federal Reserve System or the Federal Reserve Bank of Richmond.

the other hand, the machinery and electrical equipment manufacturing groups gained nearly 33,000 jobs regionwide, reaching a total of more than 350,000 by mid-year. Even the primary and fabricated metals sectors added over 6,000 jobs, and rubber and plastic products did nearly as well. These showings have structural and long-term, not just cyclical, underpinnings.

The restructuring of the regional economy has rightly been the topic of much discussion and analysis. The issue at this point, however, is how the region will fare in a period of slowing national economic growth. Where can the region look for employment and income gains in 1985? In the short run, the potential of the region continues to depend on the growth of world output and trade, and on the course of U.S. net exports.

There is still substantial cause for optimism concerning the near-term performance of regional industries and businesses. The relatively slow growth in income and employment is somewhat misleading, since major sectors of the economy are in transition. The textile industry, for instance, has invested heavily in new equipment of late. As a result, output and profitability measures tell a different story from the employment tale. Imports are a concern, to be sure; the 1984 trade deficit for textiles and apparel is likely to exceed last year's $10.6 billion record by 50 percent or more. However, it seems likely that the shakeout in the textile industry has largely run its course. The industry should maintain, or even augment, last year's gains in output and profitability, and employment should tend toward stability.

The process is somewhat less advanced among apparel and furniture manufacturers, although furniture also looks better from an output than from an employment perspective. Other prominent regional industries where year-to-year gains seem to be running ahead of economywide averages are tobacco products, paper, chemicals and household durables. These gains should hold through 1985, and might even grow if some help from export markets were to materialize.

The transportation and distribution sectors, particularly those associated with the region's several major ports, are emerging from a very good year with every expectation of further advances, especially if a pickup in exports materializes. A contributing factor, of course, has been the major expansion of U.S. coal production, much of which has occurred in the region. Coal exports have disappointed some industry observers in 1984 because, while gains have been significant, they have been almost entirely in the metallurgical segment; exports of steam coal have shown little growth. Nonetheless, a coal-production record looks well within reach in 1984, and the near-term prospects remain positive.

In sum, the regional economy could finally shake free of the drag that has been imposed by its older industrial base. Without this constraint, the region will be positioned to make real economic gains on the strength of its newer and more rapidly growing sectors. Exceptions to the pattern of the traditional industries will continue to be found in the machinery and electrical equipment groups, and more generally in the technically oriented manufacturing and service industries where recent gains reflect more than cyclical improvements in employment and output. Several significant pockets of these technically oriented industries have become well established in the region and now give impetus to the growth of new and established businesses, in addition to their government and research activities.

The Upper Southeast has discovered the severe regional effects of a national economic slowdown or downturn. Clearly, regional prosperity requires growth of the national economy. In addition, the results of 1984 suggest that international growth may also be essential. Although the outlook for the world economy is far from clear, under the assumptions of moderate U.S. growth and a modest improvement in growth for the rest of the world, 1985 looks quite good for the Upper Southeast. With any help at all from its large traditional industrial base, the region could begin to recoup the share of national employment and income it appears to have lost in 1984.

The Lower Southeast

John M. Godfrey
Barnett Banks of Florida, Inc.

LOWER SOUTHEAST
TN
MS
AL
GA
FL

The five states comprising the Lower Southeast region were driving forces behind the surge of economic activity across the nation in the first half of 1984. However, the strong growth that characterizes the cyclical rebound phase of the expansion has passed, and future gains will likely be at a slower pace, but one more sustainable in the long run. The inherent attractiveness of the Lower Southeast region will result in its continuing to show gains in population, income and jobs that are above the national averages. However, sharp differences are still apparent in the economic health of these states, suggesting that major structural changes will be required before the economic performance of all states in the region equals the national pace.

Income growth at over 10 percent has been the norm for this region in 1984, and provides solid evidence of the area's fundamental strength. This is a marked acceleration from the prior year. By this measure, Georgia, Tennessee and Alabama are leading the region but some of the strength is more apparent than real. Alabama, Mississippi and, to a lesser extent, Tennessee were unusually hard hit by the recession so that previous income peaks have not yet been exceeded. The strong rebound in these states merely reflects that extreme cyclical underpinning of the industrial base. Florida, the state experiencing the least impact from the national recession, and for nearly two and one-half years a major force lifting the nation out of the recession, continues to post solid income growth.

The states with the strongest employment gains are Florida, Georgia and Tennessee. Florida and Georgia labor markets also exhibit unemployment rates more than 1 percentage point under the national level. In contrast, lingering problems exist in Tennessee, with the unemployment rate a percentage point above the national average. These three states have not only exhibited large gains in the cyclical sectors of construction and manufacturing but also in sectors associated with long-run fundamentals—trade and financial, business and personal services. Job growth across the board reflects the attractiveness of these states.

However, nearly two years of expansion have not lifted Alabama and Mississippi over past peak levels of activity. Unemployment is down but remains above 10 percent at a time when the nation as a whole has recovered. With employment heavily concentrated in the slow-growing parts of the manufacturing sector, recovery in these states has been limited. Unless the manufacturing outlook brightens, activity in other sectors will continue below par. Construction, trade and services alone cannot make up for the lack of a full recovery in the manufacturing sector.

"America's Breadbasket"

Marvin Duncan*
Federal Reserve Bank of Kansas City

AMERICA'S BREADBASKET
ND
MN
SD
IA
NE
KS
MO

The nation's farmers can look forward to marked improvement in net farm income in 1984. The forecast $31 billion is nearly double the $16.1 billion earned in 1983. Cash receipts from both crops and livestock sales are up modestly from 1983. Direct government payments to farmers will be large—perhaps only $1.5 billion below the $9.3 billion they received in 1983.

The higher farm income in 1984 is due to a number of factors. Much larger planted acreage has yielded very large—but not record—production for major crops. Corn production was 7.55 billion bushels, soybeans 2.03 billion bushels, wheat 2.57 billion bushels, and cotton 13.3 million bales. During the early part of the previous crop-marketing year, prices received by farmers for crops exceeded those of a year earlier. The value of farm exports in 1984 reached $38 billion, up more than $3 billion from the year earlier. A substantial portion of government Payment-In-Kind payments to farmers, though earned in 1983, was received in 1984. The increase in the index of prices paid by farmers for production items was small: In October, it was only 0.25 percent above the year-earlier level. Finally, and very importantly, larger farmer-held inventories of crops and livestock are expected to add about $9 billion to net farm income; inventory reductions of $11.7 billion sharply reduced total net income in 1983.

The difference between cash income and cash expenditures—net cash farm income—is forecast to decline about 10 percent from the record high $40.1 billion earned in 1983. On the other hand, off-farm income earned by the farm sector is forecast to reach $43 billion, up 5 percent from 1983.

Despite the best farm-income year since 1981, the farm sector is troubled by financial stress. Not since before World War II have farm financial problems been so pervasive. In the Tenth Federal Reserve District, farm-business liquidations due to financial stress during the second and third quarters of 1984 were 2.8 times what agricultural bankers would consider normal, and partial liquidations were 3.0 times normal. Even greater proportions of full and partial liquidations are in prospect for the Winter of 1984-1985, as farmers settle 1984 lines of credit and arrange credit for the 1985 crop year. While farm financial stress appears concentrated in the western, midwestern and central Great Plains, the problem is really national in character. During 1984, farm asset values have declined significantly in the Southwest. But for massive infusions of subsidized credit by the Farmers Home Administration during the late 1970's, conditions in the Southeast would be far worse than now apparent.

*The views expressed are, unless otherwise indicated, those of the author; none is intended, nor should be construed, as representing the Federal Reserve Bank of Kansas City or of the Federal Reserve System.

Table 6: Net Farm Income—billions of dollars—"America's Breadbasket"

	1980	1981	1982	1983	Forecast 1984
Net cash income	37.7	35.0	36.8	40.1	36
Net farm income	21.2	31.0	22.3	16.1	32
Real net farm income (1972 dollars)	11.9	15.9	10.8	7.5	14

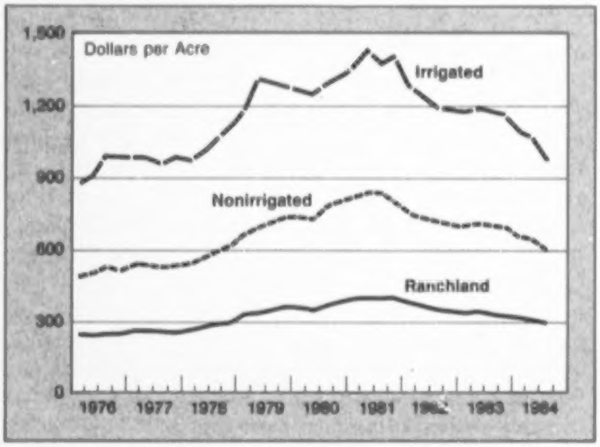
Farm financial stress has resulted from a sharp increase in the real (inflation adjusted) interest rates paid on farm debt, as well as from low commodity prices. Those farmers owning outright less than half of their farm assets have frequently found debt-servicing costs so high that their operating returns have been negative. Compounding the problem, high real interest rates and low commodity prices have caused farm asset values to decline substantially in many parts of the nation. In the Tenth Federal Reserve District, farm land values in the Fall of 1984 were about 30 percent lower than the market high reached in 1981. Moreover, further declines in land values appear likely in the year ahead.

Farm income in 1985 is unlikely to be higher than in 1984 and could be somewhat lower. Debt-carrying costs seem likely to remain quite high and the index of prices paid by farmers for production items could rise more quickly in the year ahead. Crop producers face the prospect that large planted acreage will result in another large crop in 1985, adding to carryover stocks. Thus, crop prices may average somewhat less in the year ahead. Livestock producers, however, appear poised for a profitable year in 1985. Reduced cattle and hog numbers mean lower red-meat production capacity will restrain production of pork and beef. Continued growth in employment and personal income should then result in stronger livestock prices for farmers. Higher poultry output will partially offset red-meat reductions, however.

Uncertain income prospects and high levels of financial stress mean farmers will not be good customers for capital goods. Farm-equipment manufacturers are probably in for another year of disappointing sales. Postponement of a broad range of discretionary purchases by farmers means that rural communities will also experience somewhat higher levels of financial stress in 1985.

Although the farm sector continues to experience substantial amounts of financial stress, events are setting the stage for a more lasting recovery in farm profitability within a couple of years. Farm-asset values should stabilize within a year or two at levels providing positive returns to investors. Continued economic recovery should spur export demand. Action to reduce federal budget deficits would result in both lower real interest rates and a lower value for the U.S. dollar in foreign-exchange markets. That combination of events would reduce farmers' debt-carrying costs and improve their competitive position in export markets. The stage could then be set for some modest appreciation in farm-asset values.

Farm Real Estate Values



The Southwest

William C. Gruben*
Federal Reserve Bank of Dallas

SOUTHWEST
OK
AR
TX
LA

The recent economic experience of the four states defined here as the Southwest is greatly varied. Overall, the region is recovering from the economic recession of 1981-1982, but at a slower rate than the nation. During the second half of 1984, growth in the Southwest has decelerated, as it has nationally; but the gap between the U.S. rate of growth and that of the Southwest has lately widened somewhat.

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Table 7: Recent Percent Changes in Nonfarm Employment—United States and Southwest
(Seasonally Adjusted at Annual Rates)

	Q2-1984 to Q3-1984	*State and Regional Change as Percent of National Change*	*Q3-1983 to Q3-1984*	*State and Regional Change as Percent of National Change*
United States	3.2	—	4.6	—
Southwest	1.6	50	2.4	53
Arkansas	3.3	101	4.0	87
Louisiana	1.4	44	0.8	17
Oklahoma	1.3	40	1.9	42
Texas	1.5	46	2.9	63

Over the last year, the recovery in each of the four states of the Southwest has been slower than that of the nation. Recent year-over-year growth rates of nonagricultural employment in Arkansas, Louisiana, Oklahoma and Texas vary considerably, but all fall markedly below the nation's. For the three months ending in August, the U.S. industrial production index was up 10.8 percent from the same period a year earlier, compared to only a 9.3-percent increase in the Texas index.

The rate of recovery in the Southwest has generally been declining. In the third quarter of 1984, Texas' rate of nonagricultural employment growth was 75 percent as fast as in the second quarter, 37 percent as fast as in the first quarter, and 33 percent as fast as that of the fourth quarter of 1983. Although the patterns of change in the other southwestern states differ somewhat from that of Texas, a tendency toward weakening growth is also clear in Oklahoma and Arkansas. Louisiana's growth has accelerated, but the state remains among the poorer performers in the Southwest by almost any measure.

Since Texas' income, employment and population are greater than those of the other three southwestern states combined, movements in Texas variables can mask opposing movements in the variables for the other states. Thus, while it is true that the gap between the U.S. recovery and that of the Southwest has widened, this reflects an actual widening only in Oklahoma and Texas. In Texas, the gap is widening by almost any measure. For the three months ending in August, growth in the Texas Industrial Production Index from the year-earlier period was 86 percent as fast as the growth of the U.S. index; and compared to the immediately previous three-month period, the Texas index grew only 23 percent as fast as the nation's. Growth in Texas' nonagricultural employment has also slowed relative to the nation's. While the differential between the rate of nonagricultural employment growth in the nation and in Louisiana and Arkansas has narrowed, only Arkansas has lately enjoyed growth rates that match the nation's.

The overall recovery in the Southwest has been relatively weak because the area's most important industry, energy, has performed sluggishly. Drilling has not approached the rates it achieved in 1981, although it has lately been showing year-over-year increases in Oklahoma, Louisiana and Arkansas. In Texas, drilling rates have remained below year-earlier levels. This difference in drilling experience partially explains why Texas' recovery gap vis-a-vis the nation has widened, while those of Louisiana and Arkansas have narrowed.

Other energy-related elements of the southwestern economy have also slowed the region's recovery. Refining output, for example, has been low and significant layoffs have occurred in Texas and Louisiana. It should be noted that Arkansas, the southwestern state least influenced by oil and gas extraction and refining, also has shown the strongest recovery of the four states. Until very recently, however, even Arkansas' recovery has been slower than the national pace.

Another reason why the gap between Texas' growth and the nation's has widened, while the gaps have narrowed in two other southwestern states, is seen in the patterns of construction activity. In Texas, as in other portions of the Southwest, growth in construction spending helped to fuel the early stages of the recovery. But construction spending in Texas has weakened considerably since then. Compared to a year earlier, nonresidential building expenditures in 1984 (through September) were up 17 percent for the nation, up 4 percent in Louisiana, up 18 percent in Oklahoma, and up 42 percent in Arkansas, but down 7 percent in Texas. On a similar basis, residential building expenditures were up 12 percent nationally, up 49 percent in Arkansas, up 5 percent in Louisiana, but down in Texas and Oklahoma.

Growth rates have also varied considerably among areas within the region's states. The Oklahoma City area, for example, is growing slowly, but is enjoying considerably more economic health than Tulsa. In Texas, areas dependent on energy, such as Beaumont-Port Arthur-Orange and Houston, are weaker by almost any measure than Dallas-Ft. Worth, San Antonio, or Austin, where energy is not very important but electronics and defense contracting are. Cities along the Mexican border have not fully recovered from the effects of the 1982 peso devaluations. Nevertheless, employment is growing along the border and unemployment rates there have generally been falling.

An outlook for continued sluggishness in most industries tied to energy suggests ongoing weakness in the recovery of the Southwest during 1985. Ebbing nonresidential and residential construction activity will also slow growth in income and employment in the region as a whole. Even so, the Southwest is likely to sustain its pattern of upward movement, and the electronics and defense-related urban areas will remain the most economically healthy population centers in the region.

The Mountains

Tucker Hart Adams
United Banks of Colorado

As 1984 comes to an end, the Mountain region is rebounding vigorously after enduring the worst downturn in almost 20 years. Although the region lagged the national recession by half a year, its recovery was also one-half year later than the national upturn. The strength of this recovery is borne out by the statistics. After rising a scant 0.1 percent in 1982 and 0.9 percent in 1983, nonfarm employment in the region gained a strong 4.0 percent through August, 1984, approximately three-fourths the average annual growth rate of 5.4 percent during the 1970's. Help-wanted advertising is more than double its recession low. Unemployment averaged 8.6 percent in 1983, one full percentage point below the national average; but by August, 1984, the regional unemployment rate had fallen to a low 5.6 percent, over five percentage points below its peak. Arizona and Colorado recorded the lowest unemployment rates in the region at 4.5 percent and 4.7 percent, respectively. Population growth, a meager 1.7 percent in 1983 and estimated to be 2.5 percent in 1984, remains below trend.

In 1983, regional income grew 6.4 percent, which approximated national growth. This was only three-fourths the region's trend rate in the 1970's (after inflation adjustment), and was more a reflection of the lagging regional recovery than of underlying poor growth. Indeed, by mid-1984, income in the region was advancing at 9.8 percent. Growth, however, was uneven: While Utah and Arizona payrolls advanced in excess of 11 percent, Montana registered only a 7-percent gain.

MOUNTAIN STATES
MT
ID
WY
NE
UT
CO
AZ
NM

The housing industry enjoyed a prosperous year in 1983. Housing permits rose 65 percent as declining mortgage rates unleashed pent-up demand. Despite strong initial gains in 1984, permits rose only 5.5 percent through the first three quarters. The housing recovery will be quelled by rising mortgage rates; moreover, much of the 1983 gain reflected apartment building in Arizona and Colorado, and the oversupply in this sector will cause residential construction to decrease.

Despite office vacancy rates that are stuck at almost 30 percent in Denver and Phoenix, nonresidential construction has held its own, gaining 4.8 percent in 1983 and 11.9 percent in the first three quarters of 1984. Significant nonresidential construction in Arizona offset declines in other states.

Despite higher inflation, higher interest rates, and a stagnant energy industry, the recovery in the Mountain states

Table 8: Mountain Region Economic Indicators

		Estimate	*Forecast*	*Percent Change*	
	1983	*1984*	*1985*	*1984*	*1985*
Personal income (billion $)	134.0	147.0	160.2	9.7	9.0
Retail trade (billion $)	64.0	69.9	76.2	9.2	9.0
Employment (thousands)	4,626	4,807	4,961	3.9	3.2
Unemployment (percent)	8.6	6.2	6.0	N/A	N/A
Housing construction (thousand units)	165.1	171.0	140.2	3.6	(9.9)
Nonresidential building (billion $)	4.6	5.1	5.4	10.7	6.5
Population (thousands)	12,331	12,639	12,981	2.5	2.7

will continue through 1985. Slower, yet more sustainable, growth will be evident. Population will increase 2.7 percent; although this is less than the 3.2 percent trend of the 1970's, it is in line with what is expected for the 1980's and is robust in comparison to the rest of the nation. Much of the Mountain region's population growth during the 1970's was due to net migration. As the "baby boom" generation ages out of the highly mobile years (20-29), migration to the Mountain region will slow, and bring about slower population growth.

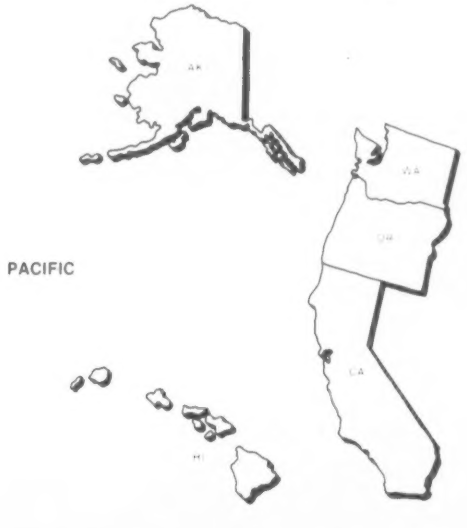
Job growth will continue to be strong in 1985. The gain will be 3.2 percent, or 154,000 jobs, but they will not be evenly distributed across the economy. Manufacturing and services will post strong growth, but the mining industry will falter. Overall, the employment rate will fall to 6.0 percent (after dropping 2.4 percentage points in 1984), as laborforce growth picks up in response to improved job opportunities.

As employment and population increase in 1985, personal income will surge 9.0 percent. Combined with an inflation rate which may reach 6.5 percent by year-end, this translates into a good gain in real purchasing power. Retail trade will also increase a healthy 9.0 percent. This growth is slightly below 1984's pace, however, and is indicative of the region's lagging recovery that caused robust growth to peak in 1984 rather than in 1983, as was the case with the nation. Moreover, growth in consumption spending will slow in 1985 as business investment continues to sustain economic activity.

Construction will weaken. Housing starts will drop nearly 10 percent in 1985 because of higher interest rates and an overbuilt multifamily sector. Nevertheless, at 140,200 units, the level of housing construction will remain above its average of the 1970's. The rise in nonresidential construction outlays will slow from the 1984 pace, and will only slightly outrun inflation. An overbuilt office market will cause that sector to suffer, but factory, retail, utility and infrastructure building will compensate for the decline.

The Pacific

Joseph A. Wahed
Wells Fargo Bank, N.A.



The economy of the Pacific region performed pretty much as expected during 1984.[1] All in all, the region's pattern was surprisingly similar to that elsewhere in the nation and any difference was one of degree rather than direction. The first half of the year was particularly vigorous but activity slackened noticeably during the Summer and early Fall. Probably the most surprising events of the year were the decline in interest rates after mid-year and the lack of inflationary pressures.

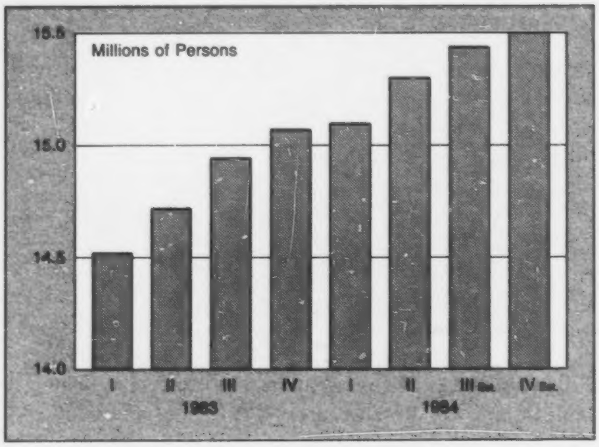
Those industries that were supposed to do well did so, while those that were perceived as still struggling early in 1984 continued in this vein during all of 1984. In brief, no major surprises. But overall, business activity for the Pacific states improved greatly. Employment rose substantially, particularly in California, and unemployment fell; sales rose in most industries, resulting in significant gains in profit margins; confidence levels improved, especially in the forest product industries of the Northwest, even though they had not fully recovered from recession. In the important tourist industry, the year 1984 was somewhat spotty. The Olympic games in Los Angeles were disappointing in their economic impact and tourist activity in general was somewhat below expectations in Southern California. However, it was a different story in Hawaii, where tourist activity rose an estimated 10 percent in 1984 and hotel occupancy rates reached a comfortable 70 percent.

Perhaps the strongest gains took place in the region's critical defense-electronic-aerospace sector. Sharply higher demand for electronic equipment and even stronger growth in military markets spurred business activity in Southern California, the San Francisco Bay Area, Seattle and Hawaii. Construction activity was also very strong, especially in the industrial and commercial sectors. Housing construction rose in the first half of the year but fell quickly during the second half because of higher mortgage rates.

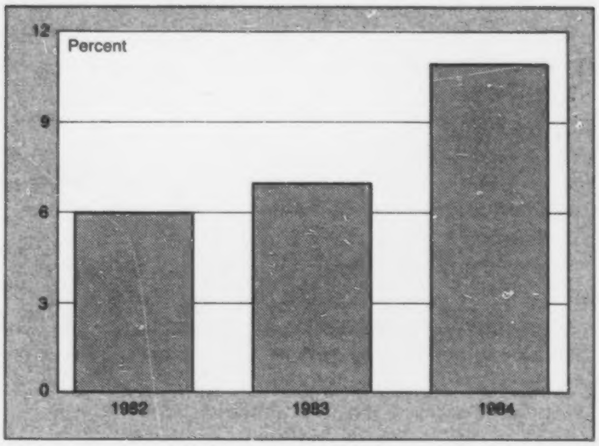
Not all industries were fortunate enough to experience

[1] The Pacific region includes California, Oregon, Washington, Alaska and Hawaii and accounts for roughly 15 percent of the U.S. economy. Its population is 34 million, of whom 15.4 million are employed. Total personal income is estimated at $476 billion; per capita income is $14,000.

Employment in the Pacific Region



Growth of Pacific Region Personal Income



growth and prosperity. Agribusiness continued to be caught in a classic cost-price squeeze and many farmers—in California and elsewhere—faced bankruptcy. In addition, a variety of export industries—including agriculture—were hit hard by foreign competition and an overvalued U.S. dollar, as well as by sluggish demand abroad. The airframe industry in Southern California and Seattle continued to feel the competition from the French-British Airbus. And, in the Pacific Northwest, the lumber industry went through a veritable seesaw as cheaper Canadian lumber entered U.S. markets and as U.S. housing activity eased after the summer months.

There was a clear disparity in growth rates among the states of the Pacific region. In Hawaii, the economy improved only moderately, despite the recovery in tourism and defense. In Alaska, weak energy prices hurt production and exploration. In Washington and Oregon, economic growth rose but it was pock-marked and erratic because of the ups and downs in housing and lumber. In California, business activity exceeded even the most optimistic expectations despite the problems facing agribusiness. The state had one of the most robust years in its history.

In the months ahead, the Pacific region is expected to continue to grow. The easing in interest rates and the growth momentum created since 1983 will be the key forces of expansion. Growth will not be as explosive as in early 1984, but it will be sustained and fairly steady. Housing should improve as mortgage-interest rates fall further while export markets *may* pick up a little as the U.S. dollar loses ground.

All in all, continued growth into 1985.

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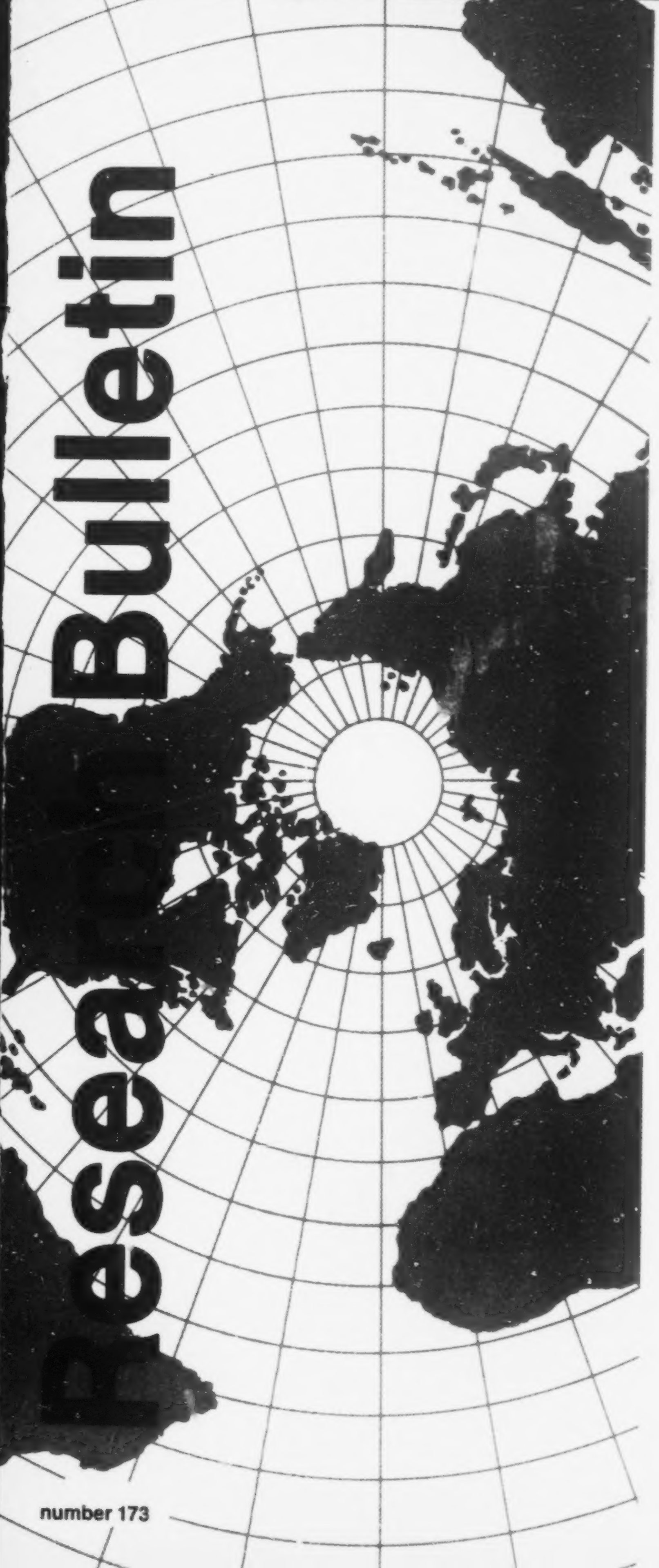

Research Bulletin

number 173

Top Executive Compensation in U.S.-Based Multinationals

by Harland Fox

The Conference Board

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THERE IS GROWING INTEREST in the compensation policies of U.S. based multinational companies and the extent, if at all, to which these policies may differ from those of U.S. corporations generally. To what extent, for example, should the senior management of a manufacturing company with a global spread be different from a company of similar size operating only within the U.S. domestic market? Presumably, the talents required to operate the multinational firm differ somewhat from those involved in running one with purely domestic concerns. Does that mean that compensation or compensation patterns should also be different?

This bulletin looks at the compensation paid in 126 of the most internationally involved U.S. manufacturing companies and compares it with a larger sample of nearly 500 manufacturing companies listed on the New York and American stock exchanges. It is hoped that this special analysis will be helpful to executives in multinational companies in the United States and abroad.

The most general conclusion of this analysis is that compensation levels and patterns in U.S. based multinationals do not differ markedly from the U.S. manufacturing industry norms. That finding alone may help put to rest long-standing speculation concerning the impact of global operations on top executive remuneration.

The Multinational Companies

A multinational company, for the purpose of this study, is any manufacturing company that meets any two of the following criteria:

(1) Thirty percent or more of total sales are outside the United States.

(2) Foreign sales are at least $250 million.

(3) Manufacturing operations controlled by the U.S. parent are located in at least five countries.

Based on an analysis of the overseas operations of some 2,000 manufacturers, 200 met the definition: 90 companies met all three criteria, and 110 companies met at least two of them.

Data on the 1983 compensation of their five highest paid executives were obtained for 126 of these manufacturers, from a study of 478 manufacturers with sales of $100 million or more whose stock is listed on the New York or American Exchange[1]. These multinational companies are classified in the tabulation below according to their 1983 sales volume.

1983 Sales	Companies Number	Companies Percent
$10 billion or over	20	16%
5—9,999 billion	16	13
4—4,999 billion	10	8
3—3,999 billion	18	14
2—2,999 billion	12	10
1—1,999 billion	22	17
500—999 million	15	12
100—499 million	13	10
Total	126	100%

Median sales for the group are $3.1 billion, with the middle half ranging between $1.2 billion and $6.1 billion.

Total Compensation

For each multinational manufacturer, compensation data were obtained for the five highest paid executives without regard to title or function. The highest paid executive is almost always the chief executive officer, and the second highest paid, the chief operating officer.

The 1983 *total compensation* of each of the five highest paid executives in each company is measured as the sum of the 1983 salary and 1983 bonus award. The median and middle 50-percent range of the total compensation of the chief executive officers and the other four executives are shown below.

Compensation Rank	1983 Total Compensation Median	1983 Total Compensation Middle 50 Percent Range
Highest Paid	$637,000	$425,000 to $825,000
Second	404,000	280,000 to 564,000
Third	333,000	235,000 to 451,000
Fourth	295,000	210,000 to 395,000
Fifth	262,000	180,000 to 360,000

As the regression lines of Chart 1 (page 4) illustrate, there is a positive relationship between the level of total com-

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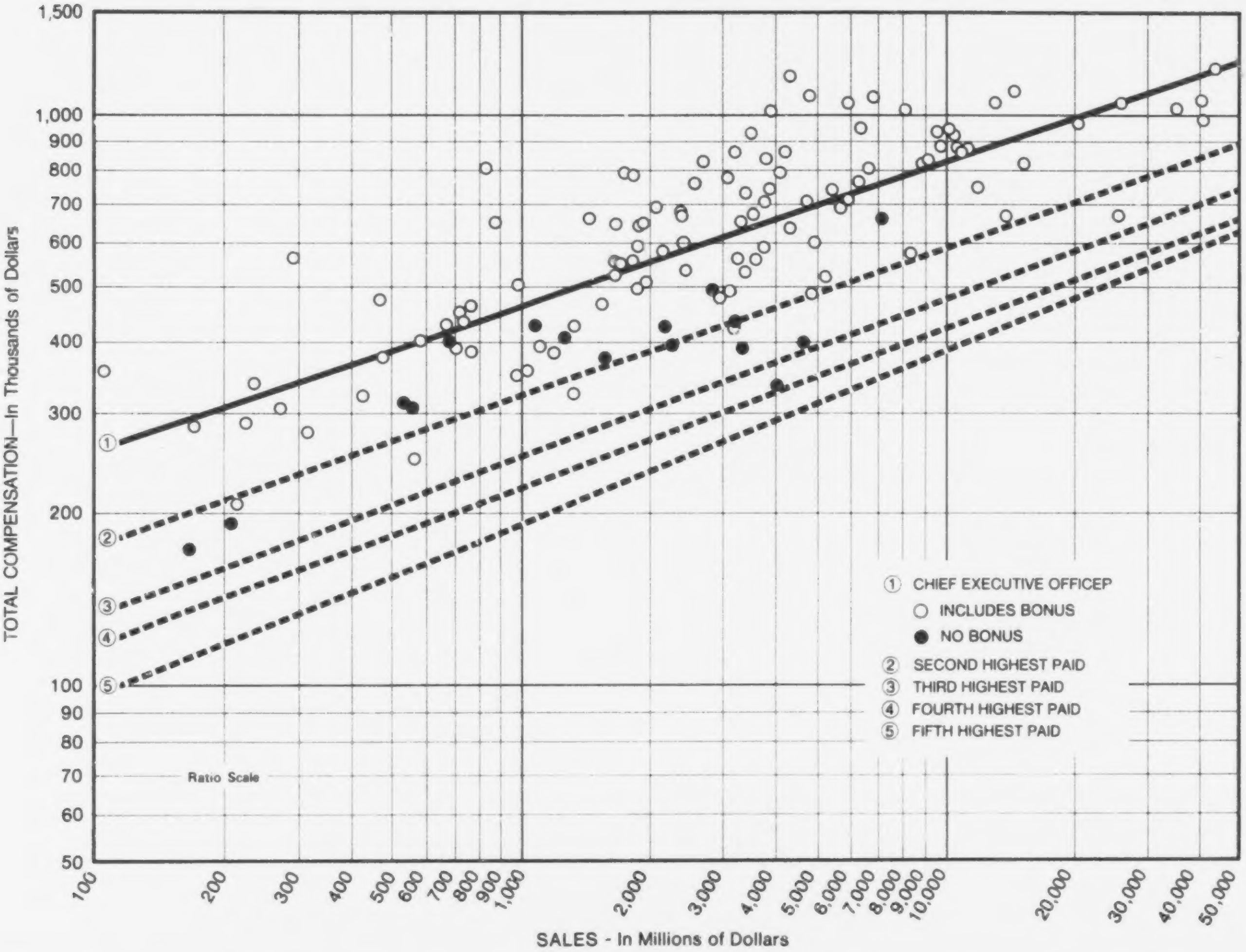
[1] See Harland Fox, *Top Executive Compensation 1985 Edition*, The Conference Board, Report No. 854, 1984, Chapter 2.

Chart 1. **Total Compensation; Five Highest Paid Executives**



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pensation and sales volume for all five executives. The correlation coefficients for the five lines are, respectively: 0.82; 0.82; 0.84; 0.83; and 0.86.

The regression lines on the chart can be used to determine the average compensation of an executive at any level of company sales, either by a direct reading from the chart or by using the regression formulas below. (In these formulas, Y is total compensation stated in *thousands* of dollars; that is, $532,000 is 532. X is sales volume stated in *millions* of dollars; that is, $248,000,000 is 248.)

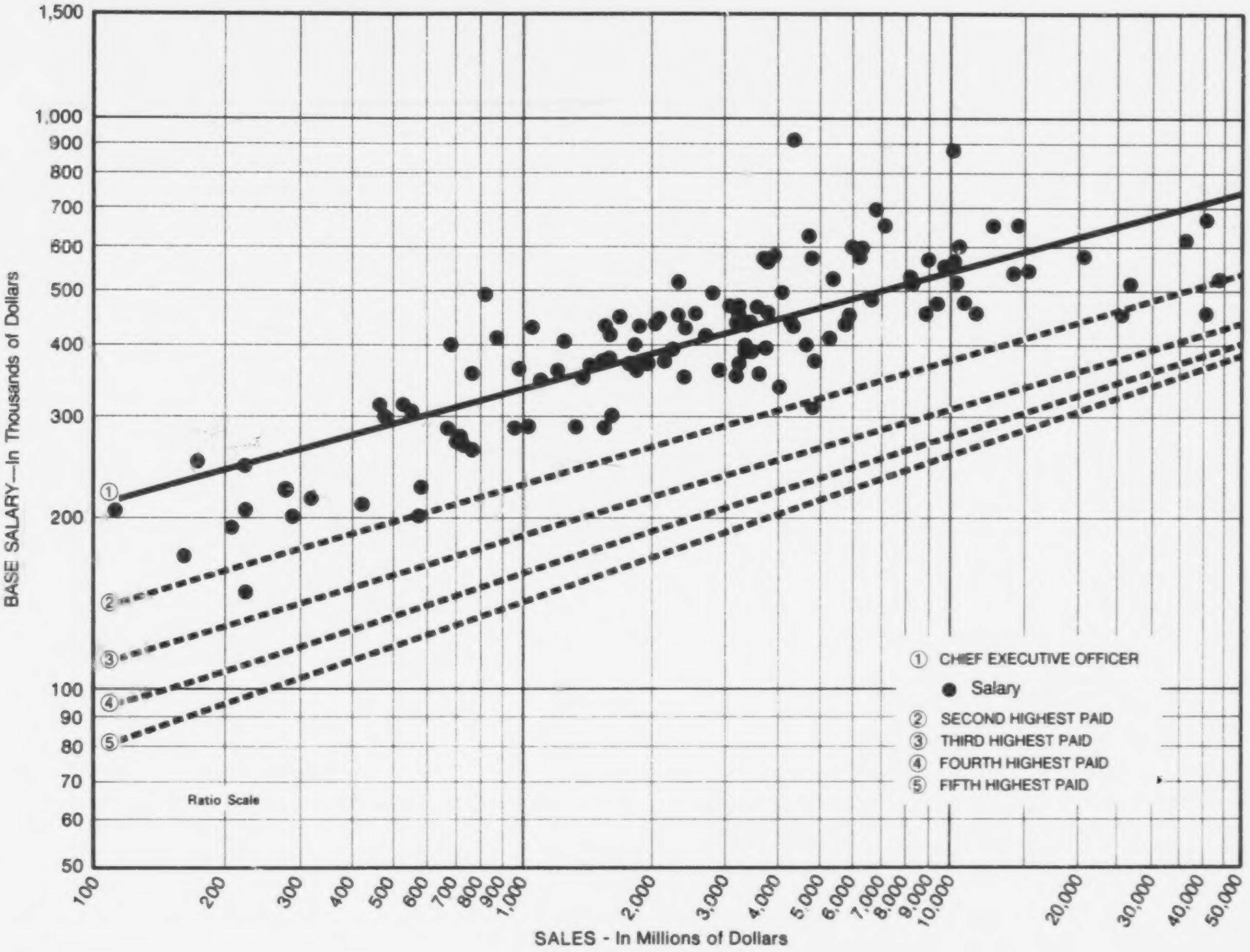
Rank	Regression Formula	r^2
Highest paid	$\log Y = 1.8378 + 0.2727 \log X$	68%
Second	$\log Y = 1.6411 + 0.2818 \log X$	67
Third	$\log Y = 1.4854 + 0.2992 \log X$	70
Fourth	$\log Y = 1.4312 + 0.2984 \log X$	69
Fifth	$\log Y = 1.3106 + 0.3191 \log X$	74

Although total compensation and sales are highly related, company size is not the sole determinant of total compensation levels. As the "coefficients of determination" (r^2) above indicate, the variation in sales volume statistically explains only 68 to 74 percent of the variation in total compensation of the five top-paid executives.

The ratio of the total compensation of each executive to that of the chief executive officer is shown below.

	Total Compensation as a Percentage of CEO's Total Compensation	
Compensation Rank	Median	Middle 50 Percent Range
Second highest	70%	61% to 79%
Third highest	54	48 to 63
Fourth highest	48	42 to 57
Fifth highest	43	37 to 50

Chart 2. **Base Salary; Five Highest Paid Executives**



Salary

The median and middle 50 percent range of the *base salary* of the five highest paid executives are shown below.

Compensation Rank	1983 Base Salary Median	Middle 50 Percent Range
Highest paid	$425,000	$350,000 to $510,000
Second	290,000	220,000 to 370,000
Third	235,000	175,000 to 305,000
Fourth	205,000	165,000 to 265,000
Fifth	190,000	140,000 to 240,000

Again, there is a strong relationship between the level of base salary and company sales volume, as illustrated on Chart 2. The correlation coefficients for the five lines are, respectively: 0.83; 0.77; 0.82; 0.83; and 0.84. The equations for these lines are shown below.

Rank	Regression Formula	r^2
Highest paid	$\log Y = 1.8803 + 0.2119 \log X$	69%
Second	$\log Y = 1.7114 + 0.2156 \log X$	60
Third	$\log Y = 1.5657 + 0.2318 \log X$	67
Fourth	$\log Y = 1.4752 + 0.2414 \log X$	69
Fifth	$\log Y = 1.4032 + 0.2498 \log X$	70

As the "coefficients of determination" (r^2) indicate, the variation in sales volume statistically explains 60 to 70 percent of the variation in base salary of the five top-paid executives. These coefficients are essentially similar to the coefficients for total compensation shown earlier.

Table 1: Annual Bonus Awards, Five Highest Paid Executives

1983 Bonus Awards (Percent of Salary)	*Chief Executives*		*Second Highest Paid*		*Third Highest Paid*		*Fourth Highest Paid*		*Fifth Highest Paid*	
	Number	*Percent*	*Number*	*Percent*	*Number*	*Percent*	*Number*	*Percent*	*Number*	*Percent*
100% or more	8	7%	7	7%	7	6%	8	7%	5	5%
90—99	4	4	2	2	–	–	2	2	3	3
80—89	6	6	5	5	5	5	1	1	5	5
70—79	11	10	9	8	9	8	10	9	6	5
60—69	23	22	20	19	16	14	10	9	10	9
50—59	17	16	23	21	17	15	26	24	18	16
40—49	13	12	12	11	19	17	16	15	21	19
30—39	7	6	10	9	13	12	14	13	17	15
20—29	10	9	12	11	11	10	13	12	9	8
Less than 20%	9	8	7	7	14	13	9	8	17	15
Total	108	100%	107	100%	111	100%	109	100%	111	100%
Median Bonus	58%		55%		50%		50%		44%	
Middle 50% Range	40–71%		35–67%		30–64%		32–64%		32–61%	
Median Salary	$432,000		$294,000		$239,000		$207,000		$192,000	

The ratio of the base salary of each executive to that of the chief executive officer is shown below.

Compensation Rank	Base Salary as a Percentage of CEO's Salary: Median	Base Salary as a Percentage of CEO's Salary: Middle 50 Percent Range
Second highest	72%	61% to 79%
Third highest	56	50 to 64
Fourth highest	50	44 to 55
Fifth highest	45	38 to 52

These base-salary ratios are essentially the same as the total compensation ratios.

Annual Bonus Awards

All but eight of the 126 multinational manufacturers have an "annual" bonus plan; that is, a plan that pays a year-end bonus that is based on that year's corporate financial performance. Based on bonus awards for 546 executives, the median bonus was the equivalent of 52 percent of base salary.[2] The middle half of the awards ranged between one-third and two-thirds of base salary.

In general, the bonus award tends to increase as a percentage of salary as base salary increases. This explains, in part, why the median award for the chief executive officers, 58 percent of salary, is larger than that for the second highest paid, 55 percent; the third and fourth highest paid, 50 percent; and the fifth highest paid, 44 percent of base salary. (See Table 1.) Similarly, bonus awards for each of the five executives tend to increase as the size of the company increases, as does base salary. (See Table 2.) Data from the table are derived from the regression equations below which are based on the pay of executives in 104 companies that paid a bonus. (The coefficients of determination are in parentheses.)

	Total Compensation	
Highest paid	$\log Y = 1.9039 + 0.2593 \log X$	(70%)
Second	$\log Y = 1.7069 + 0.2672 \log X$	(65)
Third	$\log Y = 1.5818 + 0.2770 \log X$	(70)
Fourth	$\log Y = 1.5506 + 0.2700 \log X$	(70)
Fifth	$\log Y = 1.4405 + 0.2878 \log X$	(73)
	Base Salary	
Highest paid	$\log Y = 1.8992 + 0.2049 \log X$	(69%)
Second	$\log Y = 1.7267 + 0.2088 \log X$	(58)
Third	$\log Y = 1.6044 + 0.2205 \log X$	(66)
Fourth	$\log Y = 1.5217 + 0.2277 \log X$	(67)
Fifth	$\log Y = 1.4716 + 0.2302 \log X$	(68)

Long-term Performance Share/Unit Plans

In recent years, some companies have adopted incentive plans for executives in which the reward is based on

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[2] The award for all 580 executives in the 116 companies with an annual bonus plan was not available. Some companies did not pay a bonus to all of the five top-paid executives. Other companies did not separate salary and bonus.

Table 2: Bonus Awards (as Percent of Salary) by Company Size

Executive	Sales Volume $1.2 billion	 $3.1 billion	 $6.1 billion
Chief Executive Officer			
Bonus (% Salary)	48%	54%	60%
Salary	$341,000	$417,000	$481,000
Second Highest Paid			
Bonus (% Salary)	43%	50%	55%
Salary	$237,000	$291,000	$337,000
Third Highest Paid			
Bonus (% Salary)	43%	49%	54%
Salary	$190,000	$237,000	$277,000
Fourth Highest Paid			
Bonus (% Salary)	46%	50%	53%
Salary	$165,000	$208,000	$245,000
Fifth Highest Paid			
Bonus (% Salary)	43%	48%	52%
Salary	$149,000	$189,000	$223,000

the attainment of specified *long-term* corporate financial performance goals, in contradistinction to the annual bonus plans that are based on a single year's corporate performance.

Under these plans, top executives are given a contingent award of performance units at the beginning of a performance period of three, four or five years. The initial value of each unit usually is the market value of company stock on the date of the contingent award. The actual value of the award is determined by how closely specified corporate financial performance objectives (usually growth in earnings per share) are met over the course of the performance period. As a rule, a new performance period is created each year or, in some cases, every two years; that is, performance periods overlap.[3]

Somewhat more than half (68) of the multinationals have a long-term performance share/unit plan. The plans are more common among the larger companies; for example, 72 percent of the 36 companies with sales of $5 billion or more have a plan compared with 57 percent of the 28 companies with sales of $3 to $5 billion, and 42 percent of the 62 companies with sales under $3 billion.

Seventeen companies made a payment during 1983 to one or more of their five top-paid executives under these plans. Payments to 79 executives are shown below, converted to a percentage of their 1983 base salary.

Payment as Percent of Salary	Executive Number	 Percent
100% and over	5	6%
50—99	13	16
40—49	17	22
30—39	12	15
20—29	23	30
Less than 20%	9	11
Total	79	100%

The median payment is the equivalent of 35 percent of 1983 salary, with the middle half of payments ranging between 25 and 49 percent of base salary.

Stock Option Plans

As a general rule, the long-term corporate goals on which performance share/unit plans are based are not stated in terms of an increase in the market price of company stock. Many are an attempt to get away from the vagaries of the stock market; either they are a substitute for a stock option or a complement to it.

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[3] For an analysis of the characteristics of 89 of these plans, see Harland Fox, *Executive Incentives: Long-Term Performance Share/Unit Plans*. The Conference Board, Research Bulletin No. 132, 1983.

By far the most common executive incentive plan, in which the reward is based on the long-term performance of the corporation, is the stock option plan that measures corporate performance solely by the market value of company stock. That is, an executive is given an option to purchase a specified number of shares of stock at a specified price (usually the market price on the date of the grant); the executive may exercise this option to buy during a specified period of time, usually over the ten years following the date of grant.

There are two types of corporate stock options as defined by current tax laws: the "nonqualified" option and the "incentive stock option" (ISO).[4] The major differences between an ISO and a nonqualified option are:

- Under an ISO, the executive is not taxed at the time the option is exercised if the stock is held for a year (and at least two years from the date of grant). When the stock is sold, any gain is taxed at the 20 percent, long term capital gains rate.
- Whan a nonqualified option is exercised, the executive pays tax (at ordinary income tax rates with a top marginal rate of 50 percent) on the spread between the option price and current market value. Any further gain is taxed as a capital gain when the stock is sold.
- No individual may be granted ISO's amounting to more than $100,000 in any year. Nonqualified options may be granted in any amounts.
- ISO's must be exercised in the sequence in which they are awarded. For example, if one ISO was granted at $50 per share and a subsequent ISO at $40 per share, the second grant could not be exercised before the first one even if the current market value climbed back to $50 a share. Nonqualified options have no such restriction on the sequence in which they are exercised.

Ninety percent (113) of the 126 multinational manufacturers have a stock option plan, and almost all (92) made stock option grants during 1983 to their top executives. A small group of companies granted *only* ISO's (13) or *only* nonqualified options (14); the remaining 71 percent granted *both* ISO's and nonqualified options. Among the 65 companies that granted both types of option, 74 percent used the nonqualified option only to make larger awards to those executives whose ISO grant reached the $100,000 limit noted above.

Most (85) of the 92 multinationals that granted options during 1983 provided information about the value of the option grant for one or more of their five top executives. (The value of the option is the number of shares multiplied by the market price at time of grant.) The size of the option grants for 389 executives is shown below, converted to a percentage of 1983 base salary.

Value at Time of Grant	Executives	
(Percent of Salary)	Number	Percent
400% or more	21	5%
300—399	11	3
250—299	16	4
200—249	34	9
175—199	29	7
150—174	31	8
125—149	45	12
100—124	53	14
75—99	32	8
50—74	67	17
25—49	50	13
Total	389	100%

The median value of the option grant for these executives is 122 percent of base salary, with the middle half ranging between 66 and 190 percent. (It should be noted that grants are made each year by most companies.)

The median grant to chief executive officers (134 percent of salary) is higher than that for the second and third highest paid (125 and 120 percent, respectively), and for the fourth and fifth highest paid (116 and 114 percent, respectively).

One or more of the five top-paid executives in 69 companies exercised a stock option during 1983. The net gain realized (current market value minus option price at date of grant) for 215 executives is shown below, converted to a percentage of 1983 base salary.

Gain at Exercise	Executives	
(Percent of Salary)	Number	Percent
400% or more	6	3%
300—399	6	3
200—299	8	4
150—199	13	6
100—149	31	14
75—99	18	8
50—74	33	15
25—49	43	20
15—24	23	11
Less than 15%	34	16
Total	215	100%

The median gain at exercise is the equivalent of 52 percent of base salary, with the middle half ranging between 22 and 112 percent of 1983 salary. In dollar terms, the gain ranged from less than $10,000 to almost $6 million. The median gain was $108,000, with the middle half ranging between $62,000 and $311,000.

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[4] For an analysis of the characteristics of 189 plans, see Harland Fox, *Incentive Stock Option Plans*. The Conference Board, Research Bulletin No. 148, 1983.

Restricted Stock Plans

Restricted stock plans have two major characteristics: (1) The award is an outright grant of company shares; recipients do not have to buy the stock; (2) The shares are forfeitable and nontransferable until the executive completes a specified period of continued employment with the company. The restricted stock grant is, simply, a deffered bonus award, the payout of which is contingent upon continued employment; it is a set of "golden handcuffs" designed to retain selected executives.

This required period of continued employment until *all* shares are released to the executive is the "restriction period." It runs from one to ten years after the date of grant but, most commonly, five years and three or four years. Generally, the executive can vote the shares and receive dividends during this restriction period. Dividends are taxed as received, as though they were additional salary. Similarly, when shares are released to the executive, they are taxed at the market value on the date of release (not date of grant) and taxed as though they were additional salary.[5]

One-quarter (32) of the multinational manufacturers have a restricted stock plan. Almost half (15) of them made an award during 1983. The awards for 71 executives are shown below, converted to a percentage of their 1983 base salary. For this purpose, the value of the award is market value at the time of the award.

Award as Percent of Salary	Executives	
	Number	Percent
200% or more	3	4%
100—199	10	14
40—99	11	15
30—39	13	18
20—29	19	28
Less than 20%	15	21
Total	71	100%

The median award is the equivalent of 31 percent of base salary, with the middle half of the awards ranging between 20 and 75 percent of salary.

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[5] Most plans provide for "partial vesting" during the restriction period; that is, some part of the award is made available periodically prior to the end of the restriction period. For an analysis of 91 plans, see Harland Fox, *Restricted Stock for Executives*. The Conference Board, Research Bulletin No. 159, 1984.

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The Conference Board
Research
Bulletin

No. 176

Current Issues in Corporate Telecommunications

by Nathan Weber

Management Summary

Most Corporations Plan Changes 1

92 percent of the 348 corporations surveyed plan major changes in their systems during the next three years.

Reasons for Change: Poor Service, New Technology ... 2

The decision to undertake such changes is motivated by two primary factors: Growing dissatisfaction with the quality of phone service since divestiture of AT&T on January 1, 1984; and the availability of superior technology.

Changes for Equipment, Carriers, Financing 4

Two-thirds of the corporations will change their internal phone networks, for example, by transforming desk phones into computer components capable of transmitting data as well as voice. Others will switch carriers and financing methods.

What Managers Want: Reliability 4

The two qualities that telecommunications managers seek above all in a carrier are system reliability and service. Cost is a not a primary consideration.

Bypass: A Major Trend 5

The use of bypass facilities—which enable a phone user to avoid connecting to a local phone company, thereby saving on costs—is now in use, or being planned, by over 80 percent of the firms. Almost all expect to have bypass facilities in place no later than 1988.

Public Issue: Universal Service 7

A central public policy concern regarding the use of bypass and other effects of the divestiture is the future, if any, of universal phone service.

CORPORATE RELATIONS PROGRAM

About This Report

Divestiture of the AT&T system at the start of 1984, plus the profound technological developments in voice and data transmission of the past few years, are significantly influencing the way U.S. corporations plan for and implement their telecommunications systems. To ascertain the nature of this influence and explore the actual changes taking place, The Conference Board surveyed 1,700 companies. These firms include those with sales greater than $10 million (excluding telecommunications firms), and the top 500 companies in sales, profits, employees or market value as ranked by *Forbes* Magazine. A preliminary telephone survey was conducted to identify the senior corporate official responsible for telecommunication, and 348 companies, 20 percent of the sample, provided usable responses.

Throughout the report, reference is made to "large" and "small" corporations. Those terms refer respectively to corporations with telecommunications budgets over $5 million and under $1 million.

Acknowledgments

The Conference Board offers its appreciation to numerous experts, particularly in the telecommunications industry, who offered their assistance in the preparation of this study. The initial survey design was developed by William B. Johnston.

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Current Issues in Corporate Telecommunications

Introduction

Major changes in telephone and other telecommunications systems are planned—or are currently being instituted—by a majority of U.S. corporations. Existing methods of electronic communication (usually consisting of a traditional telephone network), which have remained relatively stable for the past half century, are in the process of being radically changed. And this process of change will accelerate in scope and intensity, particularly during the next few years. Technological innovations in the transmission of voice, data and images, coupled with corporate dissatisfaction concerning the quality of telephone service following the divestiture of the AT&T system, are the two primary reasons for this development.

As a result of projected corporate expansion plans, telecommunications industry revenues are expected to leap from $14 billion in 1984 to $48 to $59 billion (in 1984 dollars) by early 1990's.[1] The following report, based on a survey of 348 companies, provides an overview of the extent and nature of the telecommunications changes planned by the U.S. industry. The impact of these changes on internal telecommunications budgets and the alterations in staffing and organization, impelled by the growing "revolution in communications," are among the most significant changes U.S. industry will have experienced during the century.

The Divestiture

On January 1, 1984, a century-old telecommunications system, having a reputation for quality far surpassing that of any other such network in the world, was dismantled. The giant U.S. corporation known alternatively as AT&T or the Bell System was split into seven smaller giants, plus AT&T itself. Each of the eight was now forced to engage in a kind of activity from which it had heretofore been protected—competition. Former "siblings" and their parent became antagonists. As often happens when a nuclear family breaks up, the departure brought about a certain degree of pain—both to the public and to the companies. How long that pain will last—and whether it will ever be replaced by pleasure (in the form of improved service and lower costs, the predicted benefits of competition)- is a matter that has been widely debated. What can be said with certainty is that the divestiture—perhaps the largest restructuring in U.S. corporate history—is already having a profound effect on the activities of the newly separate telecommunications companies, and, therefore, on the plans of the public.

Initially, the consequences of divestiture seemed to be concentrated among the competitors themselves, including the former Bell companies and such new entrants as GTE Sprint, MCI, Allnet, Rolm-IBM, General Datacom, and others. A tangled web of technical, legal and socioeconomic details, often described in esoteric, arcane language, made a full grasp of issues difficult, to say the least. For example, among the issues were:

How many wirelines slots would the FCC allot to each Standard Metropolitan Statistical Area (SMSA)? Would equal access be granted to the BOC's (Bell Operating Companies) for interLATA's and intraLATA's (local access and transport areas)? Or to AT&T's CCIS (common control information system) software program? Which agencies would regulate what services? Could computer firms move into telecommunications fields, and could phone companies make and sell computers? Was AT&T still, in effect, a monopoly holding on to the lion's share of the

Who's In Charge?

The AT&T divestiture is the event that precipitated the survey on which this report is based. The aim was to get an early view of corporate and public-policy reactions to this deregulation, and to the introduction of vastly superior technology.

One of the survey findings is that corporate telecommunications managers are no longer sure of the appropriate person (or function) in the telephone company to approach for complaints, service and so on. The complementary question is, of course: Who are the telecommunications managers who have provided the information for this survey?

An analysis of the functional titles of the respondents suggests that about half of these corporations still consider the telephone the primary means of communicating over distances, and therefore place responsibility for telecommunications under office services, general services, personnel, financial services, or as one of the functions of a vice president or corporate secretary. The others, however, defining telecommunications to include electronic data transmission, have introduced functional titles that use the word "telecommunications," or that have a "high tech" flavor—superintendent of technical services, MIS executive, information analysis manager, and so on.

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[1] "$48 Billion for Voice and Data Equipment By Mid-1990s, Says Predicasts," Predicasts, Release February 29, 1984; "Advanced Business Communication Services Will Quintuple to $59 Billion Market by 1992," International Business Research Reports, Release #1142, June, 1983.

Table 1: Corporate Telecommunications Plans

(348 Corporations)

Changes Planned for:	Percent of Respondents[1]
Internal Network (e.g., upgrading the PBX)	70%
Long distance services	62
Terminal equipment (e.g., purchasing leased phones)	58
Access to the local loop	32
Other	9
No major changes	8

[1] Multiple responses

Table 2: Projected Change in Telecommunications Budget Costs

Percent of Increase	Percent of Respondents
Under 5%	10%
5-8%	21%
9-12%	24%
13-20%	15%
More than 20%	7%
No change	13%
Decrease	11%

market; and, if so, should it be more strictly regulated than the smaller companies? Some 9,000 pages of testimony on these related matters were filed with the FCC by industry groups, state regulatory bodies, consumer advocates, and others.[2]

While such issues were being ironed out (or further entangled) in the courts as well as in Congress, telecommunications firm boardrooms, and regulatory agencies, more prosaic concerns were felt by most typical business and residential phone users: They wanted to dial their numbers, or acquire new phones, matters that entailed, at first, much the same rote behavior as they had always entailed. But no more. That the divestiture and the accompanying technological changes have influenced the telecommunications planning of a large part of U.S. industry is clear from the the present survey.

What Will Change?

Perhaps the most dramatic finding of the current survey is that an overwhelming proportion—92 percent—of the corporations studied plan some sort of major telecommunications change within the next three years. And most of these changes will affect multiple components of the firm's communications systems, including equipment, financing and carrier selections.

As Table 1 indicates, the procedure facing change in over two-thirds of the responding companies is the in-house, standard telephone system. Typically, this consists of desk phones plus a switchboard and its attendants. Most often the change will entail upgrading this network usually known as a Private Branch Exchange or PBX, into a system that can transmit both voice and data. In effect, such a revision will transform each telephone into a computer component. In addition, over half of the corporate respondents intend to change the way their firms finance terminal equipment, for example, by purchasing telephones that they now lease. An even larger percentage (62 percent) plan to switch to another carrier for their long-distance service.

Accompanying system changes will be changes in costs for telecommunications. Three quarters of the respondents expect their costs to increase during 1984 and 1985, with a quarter of the firms planning to increase their expenditures between 9 and 12 percent. (Table 2; see page 9 for further discussion of budget and costs.)

Desired Qualities

If dissatisfaction with contemporary phone service and the lure and excitement of new technology are among the primary reasons for a firm's decision to change, what qualities do the telecommunications managers look for? And what do they want to achieve for their companies when planning for a new or revised installation?

Among respondents as a whole, that is, those with both large (over $5 million) and small (under $1 million) telecommunications budgets, system *reliability* is most often cited as of primary importance. The second most frequently cited factor is the related quality of service and support. Indeed, no further factor, cost included, came close to being cited as primary. (See Table 3.)

The relatively less important factor of cost, as computed over the life cycle of a system, was further indicated in a

Table 3: Most Important Factor in Selecting a new System

Factor	Percent of Respondents
Reliability	42%
Service and support	25
Life-cycle cost	12
Flexibility and ease of use	8
Other (special features, single vendor)	13

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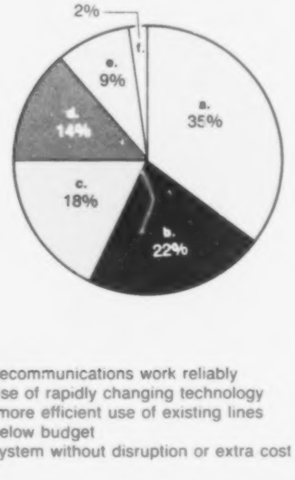
[2] "1984: Landmark Event of 50-Year History, Bell System Breakup, Dominates Scene," *Telecommunications Reports*, Vol. 50, #51-52, December 24, 1984, and numerous other issues.

chart 1:

Most Important Measure of Job Success Among Telecommunications Managers

(348 Corporations = 100%)



human resources, or personnel, context. The telecommunications managers were asked to indicate the criteria they consider most important in measuring their personal success in managing telecommunications over the next two years. The factor most often cited, by 35 percent of the respondents, was that of obtaining a system that had "reliable phones." After this came "making better use of technology"and "demonstrating more efficiency" (in that order). By comparison, cutting costs was mentioned fourth—fewer than one in seven managers identified it as crucial to their personal success in managing their firms' telecommunications system. (Chart 1) Although the cost-cutting factor as a measure of personal job success was somewhat more valued in firms with smaller telecommunications budgets, it still represents a criterion well below factors of technological or system reliability and service.

Cost considerations do become significant in one controversial area of change, known as "bypass." A host of new technologies has made it possible to bypass the local "loop"—a circuit or transmission channel that connects a phone user to a central exchange—and thereby avoid the cost imposed by that exchange. Regardless of how much companies spend on telecommunications, the cost savings far outweigh all other reasons for the decisions to bypass. In fact, cost savings in this area are cited by twice as many managers as those naming the availability of new technology. (See below for further discussion of the bypass issue.)

Deterioration of Phone Service

A year after the divestiture of the AT&T system, frustration with the quality of telephone service is almost universal among the respondents. Over four-fifths of the communications managers report that quality has deteriorated, with more than half of those so answering indicating that service "has degraded noticeably." "Very severe problems" were reported by 13 percent, and "minor problems" by another 24 percent. Almost no one believed that service had actually improved, although one out of seven discerned no significant change in either direction. (See Table 4.)

Table 4: Evaluation of Service Since Divestiture

Quality	*Percent of Respondents*[1]
Very severe problems	13%
Service has degraded noticeably	44
Minor service problems	25
No significant changes	16
Service has actually improved	3

[1] Details do not add to 100% because of rounding

Sources of Dissatisfaction

When reporting their specific grievances with current phone service, the complaint most widely mentioned was difficulty in locating personnel responsible for maintenance and information. In effect, the managers could not find mid-level managers in their phone suppliers who would take responsibility for errors and work toward correcting those complaints. There were also reports of unacceptably slow installation of equipment and mechanisms. At the same time, managers complained of a confusing plethora of vendors' options, with too little (if any) coordination among suppliers, and lack of guidelines to help make informed choices on systems and components. While about two-thirds of the respondents pointed to each of these problem areas, half expressed irritation with what they consider the mounting number of billing errors. Managers point out that rectifying errors is costly and time-consuming for the user as well as for the biller. In addition, almost half cited "slow maintenance" as one of their complaints.

Finally, the widespread dearth of competence among sales and service personnel, a noticeably lower quality in the actual transmission of voice and data, and a lack of respondents' in-house personnel having the requisite expertise to make adequate communications choices were cited as sources of complaints. (See Chart 2 for details.)

The Bypass Option

The term "bypass" refers to a form of telephone communication that avoids (or bypasses) any connection to the

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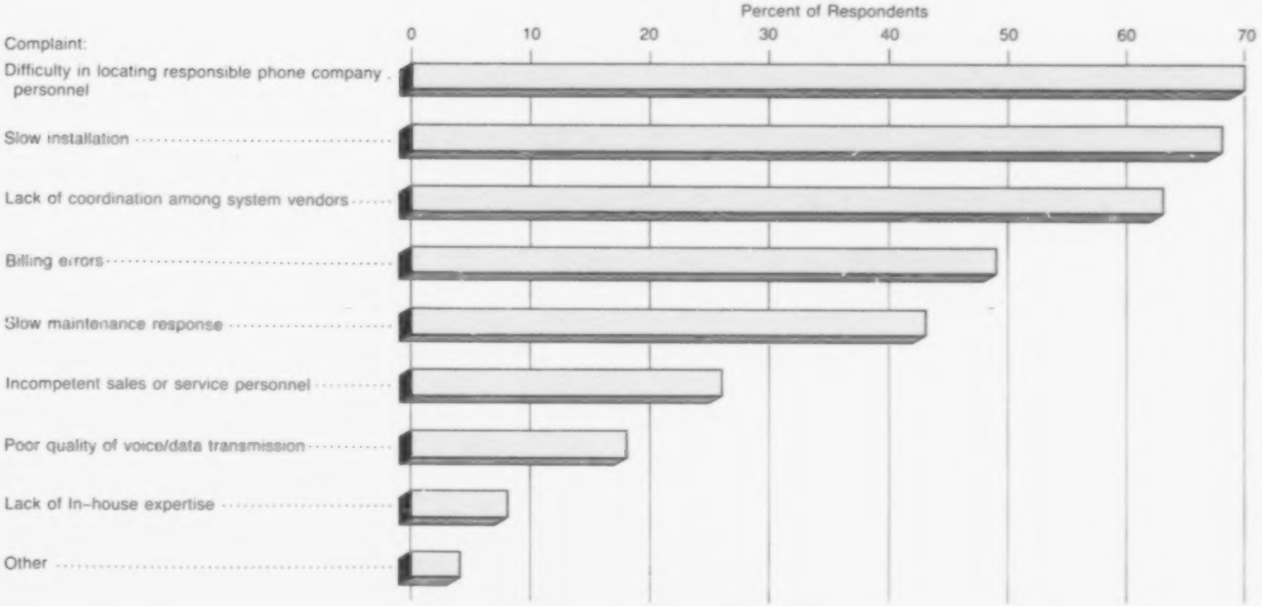
chart 2:

Most Common Complaints

(Multiple Responses)



local telephone company. Traditionally, the local phone company or exchange transmitted all phone messages made by a caller within its geographic area, whether those calls were local or long distance. While the speed of this transmission is so rapid as to be unnoticeable, there is a cost factor—of minor consequence so long as it was kept to a minimum. But as the cost rises, and as new technology makes it feasible to eliminate such electronic "detours," the appeal of bypass increases.

Over two-thirds of the respondents to this survey express significant interest in using bypass techniques. A quarter of the firms already do bypass, and the remainder are involved in varying degrees in evaluating the process. A measure of their enthusiasm is the time frame they have selected to install bypass facilities. Three-quarters of the firms plan installation no later than 1987, and another 13 percent look to use bypass techniques by 1988 or later.

Cost savings is the most important factor influencing their decision to bypass, according to more than half the respondents. (The proportions were 57 percent for the firms with smaller telecommunications budgets and 51 percent for the firms with larger budgets.) The desire to cut costs was cited more than twice as often as the next most commonly cited factor—the availability of new technology, which was mentioned by fewer than a quarter of the managers.

Increased charges by local phone companies are a partial consequence of the AT&T divestiture. While AT&T retained a virtual monopoly on both local and long distance transmission, it subsidized local usage with revenues from the more expensive long-distance calls. Such subsidies had been a mainstay of AT&T practice for half a century, reflecting a deeply rooted policy to provide affordable telephone service to virtually every home in the United States. But the entry of competitors—first in the long-distance area (even prior to divestiture), and then on the local level following the breakup—brought changes in the way phone costs were allocated. Long distance rates—reflecting actual costs—began to drop as competitors scrambled for business. Because those rates had been technically over-priced (that is, set considerably higher than the actual expense incurred by the long-distance carriers), the drop in rates seemed justified on both marketing and financial grounds.

But as long-distance rates fell, local rates, no longer subsidized, rose. In fact, they rose for two reasons. First, it was necessary to fill the "gap" left out by the withdrawal of subsidy. Second, there was a need to cover the cost of connecting the caller to a long-distance carrier. That connecting cost became known as an "access charge."

The benefits in avoiding the local exchange grow to the extent that such charges increase. As noted in a recent FCC study. "Under the access charge system of cost recovery, a moderately large business user...has an incentive to bypass switched access service and use an alternative means of carrying traffic. . . ."[3] A study by Bell Communications

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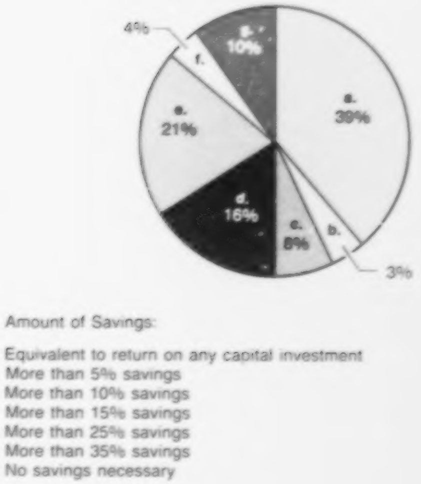
[3] Gerald W. Brock, *Bypass of the Local Exchange: A Quantitative Assessment*, (OPP Working Paper Series 12), Washington, D.C.: Federal Communications Commission, September 1984, p. 3.

Chart 3:

Savings Needed to Justify Bypass

(278 Corporations = 100%)*



*Does not equal 100% because of rounding

Research, Inc. reinforces this conclusion. The study notes that while bypass facilities and usage entail their own charges, those costs are well below the rates currently charged to the end user for originating relatively moderate volumes of toll calls.... Bypass represents an attractive alternative to switched access service for many long distance customers."[4]

Since establishing a bypass network entails a substantial investment of time and money, this Conference Board survey asked telecommunications managers to specify what level of cost savings would be needed to justify the risk. Of the alternatives offered on the questionnaire, almost 40 percent chose "any savings sufficient to provide a rate of return equivalent to our other capital projects."[5] Another 10 percent indicated that bypass could be justified on other grounds than cost savings. Among the remainder, the most frequent response was more than 25 percent savings. (See Chart 3.)

Bypass Technologies

At least seven technological systems make it possible to bypass the local telephone exchange. These systems include point-to-point microwave radio, digital termination, traditional copper cable, coaxial cable, fiber optics, cable-tv hookup, and satellites. (Such technologies can be classified, or defined, in other terms. For example, some experts cite simple "television" rather than cable-tv. Also, some technologies can be subdivided: There are, for example, several different modes of microwave transmission, designed for different volumes of data.) The dramatic advances and cost reduction in digital electronics that underlie most of the new technologies, promise to blur their present distinctions to the point where they eventually comprise one overarching means of information sharing. It is only a matter of time, many experts believe, before we all communicate primarily by "pressing the buttons."[6]

Microwave radio, according to the survey data, is the most popular of the bypass technologies, and is now utilized or is being planned for by 40 percent of the respondents. Fiber optics, a transmission method that entails the use of cable containing hundreds of tiny glass fibers, with a capacity equal to massive paired wire cables, is the second most popular medium. Table 5 shows the frequency of mention of other technologies.

Policy Concerns

"The telephone system should be universal, interdependent and intercommunicating, affording opportunity for any subscriber of any exchange to communicate with any other subscriber of any other exchange."—From AT&T's first annual report (1910), cited in W. Brooke Tunstall, *Disconnecting Parties: Managing the Bell System Break-Up,* 1985.

The public-policy implications of the growing use of bypass technology have been readily evident to federal and

Table 5: Preference for Bypass Technologies

(348 Corporations)

System	Percent of Respondents[1]
Microwave radio	40%
Fiber optic	30
Satellite	21
Digital termination system	14
Copper cable	12
Coaxial cable	12
Cable TV	7
Other	5

[1] Multiple responses

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[4] *The Impact of Access Charges on Bypass and Universal Telephone Service,* Washington D.C.: Bell Communications Research, Inc., September 1984, p. 12.

[5] The analytical considerations in setting so-called hurdle rates are discussed in Patrick J. Davey, *Managing Capital Investments.* The Conference Board, Research Bulletin No. 165, 1984.

[6] See, for example, testimony of Jim Carpenter, Bell Research Labs, *Minutes of legislative-type hearing: Proceeding on motion of the Commission as to the provision of telephone services that bypass local exchange or toll network,* Case #28710, New York State Public Service Commission, March 15, 1984, page 81ff.

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state regulatory agencies and, obviously, to the phone companies themselves. Heading the list of concerns is the extent to which by-pass techniques, by reducing revenues to the phone companies, will eventually impel those companies to curtail universal phone service. First to feel the effects of such a curtailment would be lower-income segments of the population. Lack of phone service could also spread to many who are today known as "the new poor." In an ironic twist, the recent layoffs of phone workers—to offset the decline in revenues resulting from competition—may swell the ranks of those unable to afford phone service.[7]

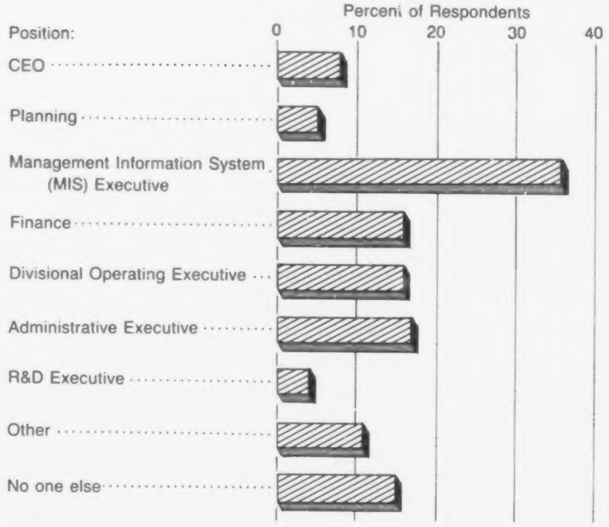
The hearings in New York during several months in 1984 present an example of the state regulatory interest in bypass. The order mandating the hearings by the State's Public Service Commission spelled out the regulatory worries. Among the stated concerns are: "To what extent and in what time frame may bypass pose a threat to toll and local exchange service and rates? Under what circumstances is local telephone network bypass in the public interest? In particular, is toll or local exchange competition necessary to assure that communications capabilities exist that fully meet the future needs of the state's economy? Does the public interest require that bypass services be regulated, and if so, in what manner? What regulatory approaches will best encourage construction of bypass facilities that serve the public interest and discourage construction of those that do not?'"[8]

On the national level, the FCC imposed a flat fee, known as an end-user charge, at the end of December, 1984. This $1-per-month charge on residential and single-line business users of phone service is to take effect in June 1985, and is to be raised to $2 the following June. At that time, the charge will be frozen. Revenue from this "end-user charge" will go directly to the local companies, where it will be used to offset the expense that they now incur when connecting a call to a long-distance carrier, and that they recoup through imposition of an "access charge." The intended effect of the new end-user charge is to lessen the desirability of bypass, and thus to counter the threat that the increasing use of bypass facilities will force the phone companies to curtail universal service. (An existing fee of $6 charged to businesses so far has not achieved that goal.) For very low-income customers who meet a state-established income means test, the end-user charge can be reduced by half, if the respective states agree.

chart 4:

Responsibility for Telecommunications Planning

(Shared with Telecommunications Manager)



Opposition to the levy of an extra charge came from consumer groups, who argued that residential users have seen their bills skyrocket in the last few years, and that other means were available to recapture revenues lost to bypass. By contrast, many in the telecommunications industry characterized the $1 addition as far too little to cover their losses.

The phone companies themselves seem to be caught in a peculiar economic dilemma. On the one hand, they will lose revenue from each customer who avoids utilizing their exchanges. They warn, therefore, that they will be forced to charge higher and higher rates to an ever-dwindling pool of users, the end-user charge notwithstanding. On the other hand, as bypass users represent a burgeoning market for special equipment, more and more of these same companies plan to provide bypass equipment of their own—equipment that will enable customers to eliminate not only their own loops but, significantly, the exchanges of their competitors as well.

Organizing for Telecommunications Change

The value accorded new or forthcoming corporate policies may often be gauged by the extent to which firms reorganize to manage these issues. By this measure, telecommunications matters are clearly valued highly by U.S. industry. In the survey, two-thirds of the 348 participating corporations have undertaken changes in organization and/or staffing to better handle their communications within the last two years. Most often—in a third of the firms—the change has consisted of consolidating the telecommunications function, which had formerly been dispersed throughout several departments.

[7] Gene Kimmelman and Mark Copper, *Divestiture: One Year Later*, Washington, D.C.: Consumer Federation of America, 1984; Lester C. Thurow, "A Rising Tide of Poverty," *Newsweek*, July 11, 1983, p. 62; John Wilke, "Surprise: Ma Bell's Babies Are Stealing the Show," and "The New AT&T Struggles to Get to its Feet," *Business Week*, December 13, 1984, pp. 92, 96.

[8] State of New York Public Service Commission, Case #28710, issued December 27, 1983.

A quarter of the companies have also altered the chain of command by shifting responsibility for the function to a different part of the corporate organization. The position of the person in charge of telecommunications was moved closer to the chief executive by 25 percent of the respondents (but only about one in twelve corporations actually placed that position in a more direct reporting relationship to the CEO).

Planning and implementation of telecommunications policy, once the responsibility of administrative management, is increasingly involving more top executives. For 90 percent of the firms, active planning or managing telecommunications is handled by personnel in addition to the telecommunications manager. Most often (36 percent of the cases), it is the executive in charge of Management Information Systems who is involved in this planning. (See Chart 4 for other personnel involved.)

Pace of Planning

Respondents were asked whether or not the recent changes in both regulation (i.e., the divestiture and related rulings) and technology had speeded up—or postponed—their plans. Two-thirds of the companies with telecommunications budgets over $5 million report that their schedules had been altered. Over two fifths of the companies with the budgets under $5 million also report schedule changes.

Table 6 presents the details of why firms with telecommunications budgets over and under $5 million either postponed or accelerated their activities. For both categories of firms, the most commonly cited cause of acceleration in corporate telecommunications planning and implementation was rising costs. The second most frequently cited cause was a recognition of the "need to control our own network."

Table 6: Reasons for Altering Telecommunications Planning

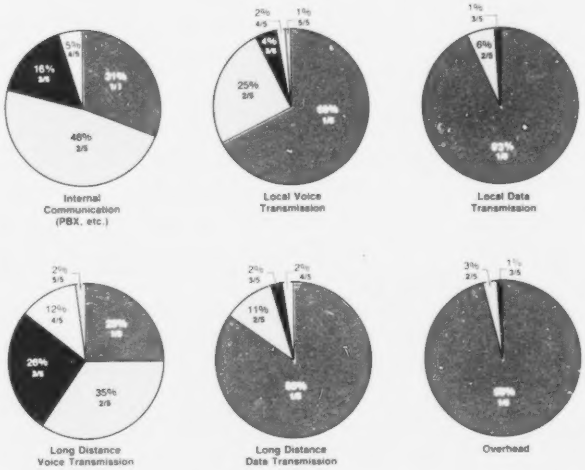
	Size of Budget	
Postponed Planning Due to[1]	*Over $5 million*	*Under $5 million*
Regulatory uncertainty	17%	11%
Technological changes	11	10
Uncertainties following Bell breakup	9	14
Accelerated Planning Due to[1]		
Rising costs	49	26
Need to control own network	37	18
Service problems	27	7
Threatened regulatory actions	20	5
Other factors	6	6

[1] Figures do not add to 100% because some respondents checked more than one category, while other repondents checked no category.

chart 5:

1983 Telecommunications Budget Allocations

Percent of Respondents



Note: Fractions inside pie sections represent portion of budget.
Percents inside pie sections represent respondents.

Budgets and Costs

Telecommunications budgets vary so widely among respondents—from a low of $40,000 to a high of over $350 million—that analysis based on simple averages would be meaningless. For the purposes of this study, firms were grouped according to the range of budgetary allocations. During 1983, a third of the firms had budgets under $1 million, another third spent between $1 and $5 million, somewhat over a fifth allocated between $5 million and $25 million, and the remainder spent upwards of that amount.

Corporate telecommunications costs tend to be apportioned among the following areas: internal communications (i.e., costs associated with PBX and equipment); voice and data over long-distance lines; and overhead. Respondents were asked to stipulate the share of their budgets that went for each of the above categories of costs. *Internal communications* and *long-distance voice transmission* received most of the corporate budget allocations. For the first category, which includes the PBX system and the terminals, half of the firms spent between 20 and 40 percent of their budgets; another third spent up to 20 percent. (See Chart 5 for further details.)

Since most of the competition within the telephone industry centered on long-distance transmission, respondents were asked to indicate their largest—most costly—source of long-distance service. Well over half (58 percent) noted

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that was AT&T's WATS (Wide Area Telephone Service) lines; no other source of long-distance service came close. For example, the second most frequently cited source was AT&T's message tolls, mentioned by under 15 percent; another 10 percent indicated AT&T's special Private Lines as their most costly long distance service.

Summary

Corporate telecommunications policy is rapidly assuming a higher priority, with appropriate alterations in staffing and organization. A change of this magnitude reflects the enormous innovations in voice and data transmission during the past several years, and the restructuring of the world's largest telephone company at the start of 1984.

One year after the divestiture of AT&T, corporate policymakers have reached several key conclusions:

- They are very dissatisfied with the existing quality of phone service;

- They expect, for the forseeable future, to budget increasing sums on new and superior voice, data and image transmission systems;

- The two primary factors that will influence their decision to select a system from one telecommunications supplier over another will be technical reliability and dependable service. The success or failure of the newly independent telecommunications firms will hinge, to a great degree, on the way they address these concerns.

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The Conference Board
Research
Bulletin
No. 178

Summer Youth Employment: 1985 Edition

By Nathan Weber

Management Summary

More Hired in 1984 3

Public-private job coalitions in 14 major cities placed 13,000 more youths during the Summer of 1984, but not all cities reported gains.

Availability Peaks 3

While youth unemployment remains high, the availability of summer jobs may have peaked.

Fast Food, Clerical Jobs 4

Most youths during the Summer of 1984 worked in fast food establishments and in clerical jobs.

CORPORATE RELATIONS PROGRAM

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THROUGH the efforts of public-private coalitions in 14 major cities, more than 13,000 young people were placed in jobs during the Summer of 1984 than during the previous Summer. As reported by coalition administrators, in most of those cities, the youths worked primarily in fast-food establishments, and in corporate and government offices where they performed clerical tasks, including word processing. A seasoned program staff in each of the 14 coalitions, year-round planning, and continued economic growth accounted for these gains. Nevertheless, only half of the program administrators foresee an increase in jobs for youths during the Summer of 1985. The others maintain that the market for summer work in their areas may have peaked—even without a worsening of the economy. As noted by the coordinator for Baltimore's program: "The need for jobs is still there; however, the market for summer help may be essentially saturated."

Table 1 compares the number of youths placed in jobs during the Summers of 1984, 1983, and 1982, in each of the 14 cities. In some of the cities the figures understate the actual number of youths who found jobs because some youths obtained employment through other means, including traditional government programs that were in place prior to the creation of the public-private coalitions. In Pittsburgh, for example, the table shows 210 youths employed; in fact, a total of 1,970 youths were placed in that city, although most of them found jobs through a program established by the city government. The Pittsburgh government program operates in much the same way as it has always functioned, except that now it is legally answerable to the Private Industry Council.

This report surveys only those programs—or facets of programs—actually administered by the relatively new private or private-public coalitions. Increasingly, however, the distinction between the traditional municipal programs and those operated through coalitions is blurring, primarily because most programs obtain federal funding. Use of those funds is dependent on establishment of a Private Industry Council (PIC), which is itself a coalition. In many cities—Richmond, Virginia, is an example—the municipal agency already serves as a subcontractor of the PIC.

Coalitions accounting for most of the 13,000 increase in employed youths include those in New York City (6,000 over 1983); Los Angeles (2,600 over 1983); Miami (1,300 over 1983); Houston (1,000 over 1983); Seattle and Boston (700 each over 1983). Table 2 presents a breakdown of jobs obtained in the private sector and in public (government and community) service.

Information on the number and type of youth placements was provided by administrators of private-public youth employment coalitions in 14 major cities.

Table 1: Summer Job Placements

	1984	*1983*	*1982*
Baltimore	3,969	3,780	1,740
Boston	1,939	1,181	852
Chicago	1,877	2,591	730
Cleveland	1,341	1,007	125
Detroit	527	400	400
Houston	6,000	5,000	3,000
Los Angeles	10,113	7,436	6,940
Miami	3,388	2,010	940
New York City	26,542	19,798	15,789
Omaha	344	370	310
Pittsburgh	210[a]	215[a]	210[a]
Richmond	890	1,177	1,086
San Francisco	1,340	1,262	806
Seattle	3,251	2,604	NA

[a] Applies only to facet of program in which corporations participate.

Table 2: 1984 Placements in Private Sector and Public Service

	Private Sector	*Public Service*
Baltimore	2,782	1,180
Boston	1,766	173
Chicago	1,451	426
Cleveland	719	622
Detroit	73	454
Houston	6,000	0
Los Angeles	10,108	5
Miami	2,863	525
New York City	26,422	120
Omaha	344	0
Pittsburgh	0	210
Richmond	510	380
San Francisco	1,222	118
Seattle	240	3,011

Youth Unemployment

While the increased placements reported by the programs offer reason for optimism, they represent at best a tiny dent in a continuing, pervasive problem.

The national unemployment picture for youths between the ages of 16 and 19 showed some improvement over the previous Summer, but remained at extremely high levels. According to the U.S. Bureau of Labor Statistics, youth unemployment nationwide stood at 18.4 percent (seasonally adjusted) for the months of July and August, 1984—virtually three times the adult unemployment rate for the same period. And for black youths, the rate reached 42.3 percent. During the previous Summer, the respective rates were 23 percent for all youths, and 50 percent for black youths.

Federal unemployment figures tend to understate the actual number of both youths and adults who are jobless but capable of working. They do not include those officially designated as "discouraged workers," that is, people who have ceased looking for employment after experiencing a fruitless job search.

Furthermore, the reported decline in the youth unemployment rate does not mean that the equivalent number of youths actually found jobs. Part of the reported decline is attributable to a lowering of the number of youths entering the labor market in 1984—which reflects a reduction of the teenage population caused by an aging of the post-World War II baby-boomers, according to the Bureau of Labor Statistics (BLS).[1] A similar factor accounts, in part, for a reduction in the adult unemployment rate. According to the Research Institute of America: "One reason behind the sudden and unexpected unemployment drop: Married women with kids aren't rushing into the labor force. . . . Women with children flooded the labor market in the late '70s and up to the 1981-82 recession in order to cope with inflation. But as inflation ebbed, the urgent need to replace purchasing power lost to inflation became less urgent and more women stayed home."[2] To the extent that the decrease in the youth unemployment rate does not reflect a significant gain in actual employment, the future prospects for today's young workers are disturbing. As documented in a study released at the start of 1984 by the National Planning Association: "In short, the evidence is that long duration unemployment in the early years in the labor market will lower earnings for a long time. . . . Thus, youth, especially minorities, experiencing unemployment during the first part of the 1980s will have lower wages throughout the decade."[3]

Where the Jobs Are

As shown in Table 3, the largest number of jobs in most of the cities were in fast-food establishments and in clerical-secretarial work. Both fast food and clerical work are expected to provide most of the youth jobs next Summer, according to program administrators.

While any starting job can provide valuable basic employment skills, contemporary office work is more likely to offer training that can be successfully marketed later on, particularly in offices utilizing word processors. In eight cities—Baltimore, Boston, Chicago, Los Angeles, Miami, New York City, Seattle and San Francisco—clerical and secretarial work, including word processing, accounted for approximately a quarter to a half of the jobs. A promising innovation in Boston was the establishment of mini-academies in word processing, typing and office procedures for students, including four to six weeks of training at a central facility, directly prior to job placement. Seattle also provided paid work training for eight weeks, after which some youths were placed in permanent private-sector jobs.

Youths also found work as maintenance, stock and retail clerks, tutors, health-facility and day-care aides, auto repair and laboratory assistants, machinists, light assembly workers, house painters, minor home repairers, messengers, community cleanup workers, lifeguards, amusement park aides, and cashiers.

Program Improvements

Improvements in program planning and administration were reported by most of the administrators. Heading the list of changes from the Summer of 1983 were earlier planning, increased coordination among participants in the various coalitions, and tighter program operations through, for example, centralization.

Several cities, including New York, Houston and Richmond, placed added emphasis in 1984 on informing employers of the financial benefits in utilizing the Targeted Jobs Tax Credit. The TJTC—which was extended by Congress through the end of 1985—provides employers with a tax credit of 85 percent of the first $3,000 they pay in salaries to low-income 16- and 17-year-old youths hired during the Summer. A study prepared for the U.S. Department of Labor found that the relatively low utilization of the TJTC was due, in part, to ineffective promotion of the program.[4]

Chicago centralized the administration of its project, and computerized the matching of applicants to jobs. Improved marketing of the youth-employment effort to corporations was reported by Richmond, Seattle and Houston. Detroit's efforts to solicit corporate participants were enhanced by White House recognition for its 1983 program. Miami increased its media coverage, as did Houston. Baltimore appointed a year-round summer-jobs coordinator, and secured two co-chairmen to head its business committee.

Of major interest were the successful efforts of three cities to transform summer jobs into permanent full-time or part-time employment. Those cities were Miami, Seattle and Boston—with the latter noting that an impressive 39 percent of its youthful placements were able to continue

---

[1] "Flood of Teenagers Into Job Market in Summer of 1984 Will Be Smaller," *Daily Labor Report*. May 29, 1984, p. A-10.

[2] *Research Institute Report*, January 13, 1984, p. 2. Also Alan Murray, "Growth of Labor Force Slows, Raising Hopes of Lower Jobless Rates," *Wall Street Journal*, January, 4, 1984.

[3] Daniel H. Saks, *Distressed Workers in the Eighties*, Washington, D.C.: National Planning Association, 1983, p. 26.

[4] Philip Richardson and others, *Study of Targeted Jobs Tax Credit Summer Youth Experience*, Washington, D.C.: Prepared for the Employment and Training Administration, U.S. Department of Labor, April, 1984.

Table 3: Where Youths Were Placed

	Fast Food	Clerical–Secretarial–Word Processing	Delivery	Community Improvement (Cleanup)	Other (Maintenance, Repair, Tutors, Social Service, Sales, etc.)
			Percent of Placements		
Baltimore	10%	30%	1%	12%	47%
Boston	1	53	6	1	39
Chicago	8	62	10		20
Cleveland	26	6	1		67
Detroit		10	43	45	3
Houston	40	8	10		42
Los Angeles	50	35	10	5	
Miami	39	31	9	15	6
New York City	55	23	7		12
Omaha	25	11	1	12	51
Pittsburgh				100[a]	
Richmond[1]					
San Francisco	21	52	1	3	23
Seattle	4	55	1	8	32

[a] Pertains only to one facet of Pittsburgh's program (see page 3).
[1] Information not available.
Details do not add to 100% because of rounding.

on the job part-time after the Summer ended. Baltimore was able to guarantee summer jobs to students who made the honor roll and who maintained excellent school attendance records. And Detroit enrollees participated in a mock trial in which they undertook the roles of judge, attorney and jurors as part of a six-week law-education project. Other Detroit students studied minor home repair.

Legislative Developments

Several bills pertaining to youth unemployment were before the Congress during 1984. They included a bill to provide additional funding for summer jobs under the Job Training Partnership Act, a bill to establish a subminimum wage, and a bill to provide part-time jobs and training skills to high school students.

Summer Jobs Funding

On July 2, 1984, President Reagan signed Public Law 98–332, to provide $100 million for an additional 100,000 summer jobs for young people. Numerous city officials asked for the additional money when they discovered that their grants for 1984 would amount to less than those for the previous Summer, which had been distributed under the now-defunct Comprehensive Employment and Training Act (CETA). With the replacement of CETA by the Job Training Partnership Act (JTPA), funding for summer jobs is spread out over 100 more jurisdictions (known as Service Delivery Areas). Thus cities like Chicago, Cleveland and Dallas stood to lose over 40 percent of their funding. Furthermore, the old "hold harmless" clause in CETA, which limited how much a community's grant could be reduced from its previous year's grant, was discontinued under JTPA.

But it was not merely the decrease in funds that provoked controversy.[5] Those funds were part of a $1.4 billion emergency spending bill, which included funding for child nutrition and food for low-income pregnant and nursing women—and an additional $21 million in covert aid against the Sandinista government in Nicaragua. After several months of often vituperative debate, mainly between the Administration and Congress, the spending bill was passed without the covert aid funds.

Subminimum Wage

Controversy also marked introduction of President Reagan's subminimum-wage proposal. The proposal would have enabled employers to pay only $2.50 an hour to youths during the Summer—or 75 percent of the current minimum of $3.35. Spokespersons for the proposal, including Secretary of Labor Raymond J. Donovan, argued that, by reducing the cost to employers—primarily small businesses—the subminimum wage would enable many more youths to be hired.

Supporters of the proposal included the Chamber of Commerce of the United States, the National Alliance of Business (NAB), and—with reservations—the National Conference of Black Mayors. The NCBM endorsed the concept as an experiment for one Summer, provided the subminimum wage did not result in the replacement of adults by youths. Similarly, the NAB conditioned its support on a recommendation that legislation contain a provision "allowing for early termination" if an annual evaluation of the program reveals "ineffectiveness or abuse." The Administration's bill, known as the Youth Employment Opportunity Wage Act of 1984, did contain a provision prohibiting employers from replacing adults working at or above the minimum with youths hired at the subminimum.

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[5] "Plans to Add $100 Million for Summer Youth Jobs Being Delayed in Congress," *Daily Labor Report*, April, 25, 1984, p. A-11.

Opponents of the proposal included organized labor, the Black Congressional Caucus of the House of Representatives, and Senator Edward M. Kennedy (D-Mass.) and Representative Augustus F. Hawkins (D-Cal.), who introduced an alternative bill. (See "Jobs During School" below.)

Critics argued that the proposal would merely encourage the substitution of older for younger workers, notwithstanding the bill's prohibition of that eventuality. Representative George Miller (D-Cal.) maintained that enforcement of even the present minimum is poor, and that studies of earlier subminimum wage plans concluded that displacement of older workers was predictable.[6] Other opponents saw the proposal as constituting a "two-tiered racial minimum wage" and, therefore, comprising "apartheid, American style."[7] They maintained that no evidence existed to demonstrate that more youths would, in fact, be hired under a subminimum wage. The proposal died in Congress.

Jobs During School

A third initiative, sponsored by Senator Kennedy and Representative Hawkins, was designed to provide part-time jobs for low-income students during the school term, and full-time jobs in the Summer. Entitled the Youth Incentive Employment Act, the bill provided for federal appropriations of $2 billion for fiscal 1985, to subsidize the initial salaries of the enrollees.

Summer work, either in public or for-profit organizations, would have to be a continuation of the work performed during the school year. Based on an experimental program in which 76,000 youths participated between 1977 and 1980, the legislation aimed to encourage potential dropouts to remain in school and to provide them with marketable training. While it did not engender the intense opposition that greeted the subminimum wage proposal, the Kennedy-Hawkins legislation was not voted out of committee.

Resources

Several new publications for administrators of summer youth-employment programs became available during 1984. Among them were: *A Practitioner's Guide: Strategies, Programs, and Resources for Youth Employability Development,* Public-Private Ventures, Philadelphia, Pennsylvania. which offers recommendations and presents case studies; *JTPA Follow-Up: A Decision-Maker's Guide to the Issues.* National Governors' Association, Washington, D.C., which provides information on developing usable performance measurement and reporting methods under the Job Training and Partnership Act; *Work-America,* the monthly newsletter of the National Alliance of Business, which provides up-to-date reports on job-training partnerships in localities across the country. In March, the NAB was the recipient of a $7.5 million grant from the U.S. Labor Department to provide technical assistance and support to the private sector to implement programs for low-income youth and dislocated workers under the JTPA. The grant extends through June, 1985.

Corporate Initiatives

In addition to participating in Private Industry Councils or other coalitions, some corporations conduct their own programs to address the issue of summer joblessness. In Detroit, the Michigan Consolidated Gas Company provided $127,000 to nine agencies to hire 200 youths. The young workers were employed to weatherize homes for senior citizens, tutor other teenagers in reading and math, assist with child care services, repair autos, and participate in neighborhood improvement projects.

Chevron—the Standard Oil Company of California—announced in May, 1984, that it was providing $250,000 to hire youths in 18 cities. In a statement issued to the press, Chevron officials noted that its "first of its kind" project will provide "meaningful job experiences for young people who need them to prepare for future employment. We're pleased that regular, punctual attendance, attention to the quality of work, and productivity are integral facets of the programs." Such goals motivate the operations of private and private-public youth employment coalitions throughout the country.

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[6] "Administration's Subminimum Wage Plan Faces Bleak Future in Congress," *Daily Labor Report,* July 10, 1984, p. A-14.

[7] See comments of Rep. Gus Savage (D-Ill.) in "President's Subminimum Wage Plan Draws Strong Black Caucus Criticism," *Daily Labor Report,* May 18, 1984, p. A-13.

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The Conference Board
Research
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No. 177

Corporate Financial Assistance for Child Care

By Dana Friedman

Management Summary

Financing—The Most Popular Child Care Option 3
Among an estimated 1800 employers providing child care assistance, the majority of companies help their employees pay for child care.

Several Ways to Finance Child Care 10
Employers can provide vouchers, discounts, or dependent care as an option in a flexible benefits plan.

Vouchers 12
As a direct subsidy to employees, eligibility is usually limited to control costs.

Discounts 16
By contracting with local day care programs, employers can save parents $500 per year in child care expenses.

Flexible Benefits 20
As the most popular financing option, flexible benefits allows employees to receive pre-tax dollars to spend on child care.

Other Financing Options 33
Some employers subsidize employees using the company-sponsored day care center; others make corporate contributions to local programs, establish VEBA's, or lobby the government for increased support.

Salary Reduction and the Tax Credit 37
Some employees may fare better using the Dependent Care Tax Credit rather than salary reduction.

WORK AND FAMILY INFORMATION CENTER

Terms Used in This Report

This is an area in which some everyday words have developed specialized meaning.

Child Care, Day Care: Care of infants, preschoolers or school-age children by someone other than parents. Children's advocates prefer the term "child care" to avoid confusion with "adult day care" and to change the field's image from what used to be thought of as a custodial, babysitting service for the poor.

Day-care Center: A facility that cares for more than six children: includes preschools, nursery schools, prekindergarten programs, and child-care centers. Most programs have an educational or developmental focus and must be licensed by the state. There are an estimated 20,000-30,000 full-day day-care centers in the United States as of early 1985. Not included in this number are half-day nursery schools and kindergarten programs in the public schools.

On-site Day-care Center: A child-care facility operated on or near company premises, which may be owned and operated by the company or contracted out to a profit or nonprofit agency to run for the employer. As of January, 1985, there were an estimated 120 on-site centers at companies, 400 at hospitals, and 50 sponsored by public agencies.

Family Day-care Home: The most common form of child care in which a neighbor, usually a woman, cares for up to six children in her own home. An estimated 5 million children are cared for in family day-care homes. Most states require homes to be licensed or registered, although an estimated 70 percent are not.

Dependent Care Assistance Plan (DCAP): A written plan required by Section 129 of the Internal Revenue Code as stipulated in the 1981 Economic Recovery Tax Act. The plan makes employer contributions to the care of children, elderly parents, and disabled dependents nontaxable to the employee and tax deductible to the employer.

Resource and Referral (R&R): Also known as "Information and Referral." A counseling service for parents to help them find available child care in the community. These agencies (usually nonprofit) keep computerized lists of services indicating their location, hours, fees and availability. They also help stimulate the supply of services where needed. An estimated 200 R&R agencies exist across the country. Some are designed to administer voucher programs for local employers.

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The Conference Board
Research
Bulletin

Corporate Financial Assistance for Child Care

Part 1

Introduction

Since 1980, there has been dramatic growth in the portion of the United States labor force that must purchase child-care services in order to work. Inflation increased the need for the two-paycheck family. Divorce contributed to the number of single parents serving as sole support of their families. Attitudinal changes—growth of the service economy, and equal-opportunity legislation among them—further increased the labor-force participation of mothers—most of whom are part of the baby-boom generation. These factors have created an unprecedented need for child care at a time when affordable, quality services are beyond the reach of many working parents.

Employers concerned about attracting and retaining a productive work force have begun to address the child-care needs of their employees. According to The Conference Board's Work and Family Information Center, approximately 1,800 employers currently provide some form of child-care assistance. The corporate response includes on-site day-care centers, after-school care programs, sick-child care, information and counseling services, and corporate contributions to community-based programs. However, the majority of employers provide some form of financial assistance for child care.

The popularity of a monetary response to child-care needs can be attributed to at least two factors. First, employers realize that affordability may be the most significant child-care problem facing working parents. Parents' inability to purchase reliable, quality child care may be the cause of absenteeism and poor work performance. The second reason for the growth of corporate financing of child care is found in the tax laws. With passage of the 1981 Economic Recovery Tax Act (ERTA), child care became a nontaxable benefit and a convenient option to include in flexible benefit plans and salary-reduction programs. These forms of flexible compensation proliferated after passage of the Revenue Act of 1978, and child care, as a benefit, grew along with them.

Types of Financial Assistance

The employer's goals determine the form of financial assistance the company will provide to help employees absorb child-care costs. Where the employer's primary concern is the effect of inadequate child care on employees, management might subsidize employees' child-care costs through a voucher or vendor-discount plan. For example, the Polaroid Corporation offers vouchers—worth up to 80 percent of the cost of care—to purchase child care in the community. Kinder-Care, a profit-making chain of day-care centers, has contracts with 75 corporations for a variety of services including a 20-percent discount at Kinder-Care centers. Participating centers reduce their fees by 10 percent and the companies contribute 10 percent of the weekly fees.

Other employers focus initially on the appropriateness and cost of their benefit plans. In their attempts to satisfy the new diversity in their work forces, while simultaneously controlling benefit costs, companies offer child care as one of a number of benefit choices in a flexible benefit, or "cafeteria," plan.[1] In a comprehensive cafeteria plan, employees can select from a menu of benefits those they need most in exchange for other, less-needed, benefits. The flexible spending account, or reimbursement account, is another form of flexible benefits that is usually funded through salary reduction. These programs allow an employee to spend pre-tax dollars on child care or other benefits. Because no employer contribution is required, this form of flexible benefits is the most popular form of financial assistance for child care.

This report describes four different corporate initiatives that help employees pay for work-related child-care expenses: vouchers, discounts, comprehensive cafeteria plans, and flexible spending accounts with salary reduction. Several other options, such as corporate contributions to community programs, subsidizing on-site centers, Voluntary Employee Beneficiary Associations (VEBA's), and lobbying are mentioned briefly. While the tax law permits employers to assist with the cost of care for elderly parents and disabled dependents, this report focuses only on the financing of care for infants, preschoolers and school-age children.

The practice of corporate financing for child care is very much a moving target. However, the structure of various model programs can be identified. The voucher programs offer opportunities for the most creativity and several models are identified and described in this report. There is less variety in the structure of discounts and typical corporate experiences are covered. This study takes into account recent developments in the regulation of flexible benefits. The models presented in this report appear to be representative of the flexible programs currently in place.

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[1] See Mitchell Meyer, *Flexible Employee Benefit Plans: Companies' Experiences*. The Conference Board, Report No. 831, 1983.

About This Report

The information in this report is based on a survey of employers known to provide child-care vouchers and discounts, or to include child care in their flexible benefit plans.

A total of 113 surveys were distributed, to which 38 companies responded with usable information. An additional 20 company programs are described, based on information provided at conferences and in the literature.

The first task in this study was to identify the employers with experience in providing one of the four selected financing mechanisms. The Work and Family Information Center of The Conference Board is in the process of developing a computerized data bank, which will eventually include all such company programs; however, no comprehensive list currently exists. Therefore, an informal network of child-care organizations and benefit-consulting firms were contacted in the Fall of 1983 to identify companies with various types of programs for financing child care. Additional examples were identified at conferences and through a literature search.

In order to identify employers with voucher plans, child-care consultants, information and referral agencies, and advocacy groups were contacted in 25 U.S. cities. To this list were added the names of employers providing vouchers identified by the National Employer Supported Child Care Project and by research sponsored by the American Management Association. This process provided a list of twenty-three companies with voucher plans. Six of these companies responded to The Conference Board's survey.

The discount program is typically offered by profit-making chains of day-care centers. Kinder-Care, the largest of these chains, shared its list of participating companies. Of the 75 companies offering Kinder-Care discounts, 11 responded to the survey. The remaining three companies offering discounts and responding to the survey were identified by the Children's World chain and Community Coordinated Child Care (4C) of Central Florida. Although several other chains would not release their lists of clients, their experience with company discounts is reflected in the report.

It was more difficult to obtain a list of companies with flexible benefit plans that include a dependent-care option. Leading benefit-consulting firms, the Employers Council on Flexible Compensation, and the Employee Benefits Research Institute were able to name the larger corporations with comprehensive cafeteria plans. Several programs in smaller-sized companies, hospitals, municipalities and nonprofit agencies were identified through local contacts in several U.S. cities. However, this report focuses primarily on the experiences of larger corporations. Of a group of 27 employers offering flexible plans, 15 responded to the survey; seven employers explained that their plans did not include dependent care.

History of Employer-Supported Child Care

During the Civil War, manufacturers of ammunition and soldiers' clothing established day nurseries so that women could help in the war effort. A similar need prompted hospitals and war-related industries to create day-care centers during World War I and, with government funds provided under the Lanham Act, nearly 2,500 day-care centers were established at plants during the Second World War.

After World War II, industry's interest in child care waned. Interest was restimulated in 1967, when Congress passed legislation allowing for the rapid tax amortization of capital expenses for on-site day-care centers. Gerber Foods, among others, opened day-care centers expecting to make a profit. Other companies, such as Stride Rite Shoes, KLH, and Polaroid Corporation, provided child-care assistance as a way to express corporate social responsibility. During the period between 1964 and 1972, approximately 18 corporate on-site day-care centers and 70 hospital-based centers for employees' children were opened. Fifteen of the corporate centers have closed; only Stride Rite, Photo Corporation of America, and Forney Engineering are still operating.[2]

More than a decade after the last flurry of interest in employer-supported child care, at least 1,800 employers provide child-care assistance. However, recent interest in child care is characterized by the alternatives to on-site day-care centers. Not only have companies learned from the lessons of earlier center closings, they have also recognized the inappropriateness of the on-site solution given management objectives, parent preferences, and children's special needs. Parents may not need a service at the workplace as much as they may need help in finding, selecting or paying for child care already available in the community. They may also need more conveniently arranged time to balance family and work responsibilities.

Reasons for Employer Involvement

Less than a quarter of U.S. families are composed of a male breadwinner nourishing his wife at home and 2.6 children.[3] As family structures change, so does the composition of the work force. In order for a business to attract and retain a productive work force, it has begun to consider the family needs of its workers. According to an analysis of census data by the Children's Defense Fund, (a national advocacy organization in Washington, D.C.), 80 percent of women in the work force are of child-bearing age and an estimated 93 percent of these women workers will become pregnant some time during their work careers. Since two-thirds of the new entrants into the labor market by 1990 will be women, their needs are likely to play a role in the design of recruitment efforts, productivity incentives, and benefit plans. And because nearly 60 percent of married men in the work force have wives working full- or part-time, they, too, have family concerns that differ greatly from those of the male breadwinner for whom benefit plans and work schedules were originally designed.[4]

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[2] For historical information on employer-supported child care, see: Women's Bureau, U.S. Department of Labor. *Employers and Child Care: Establishing Services at the Workplace.* Washington, DC: U.S. Government Printing Office, 1982; Welfare Research, Inc. *On-Site Day Care: The State of the Art and Model Development.* Albany, NY: Welfare Research, Inc., 1980. (Available from Molly Hardy, Empire State Day Care Services, Inc., Agency Building #2, 12th Floor, Albany, NY 12223.

[3] Bureau of the Census, U.S. Department of Commerce. "Marital Status and Living Arrangements: March 1980." Current Population Reports, Series P-20, 1981.

An increasing number of employers are concerned about producing goods and services in competitive world markets and recruiting workers in tight labor markets. Although there are pockets of unemployment in some older industrial firms, at the same time, there are labor shortages in some parts of the high-technology and service industries. Companies in Silicon Valley, California, the Research Triangle, North Carolina, and along Route 128 outside Boston have expressed more interest in family issues than have employers in Detroit, Akron or Toledo.[5]

Over 40 percent of the labor force—about 40 million workers—have children under the age of 18. (A growing number are also likely to have elderly parents or disabled dependents.) Child care is one of the most pervasive needs because family members are not available to care for young children during the day.

The fastest-growing segment of the work force consists of mothers of preschool children, 52 percent of whom were in the labor force in 1984. The increase in the proportion of mothers with children under three is even more dramatic: In 1975, 34 percent of this group worked; by 1984, the figure had increased to 48 percent. It is expected that, by 1990, 64 percent of all families with children will include working mothers with responsibility for approximately 10.4 million children under the age of six. Nearly 20 percent of these children will live in single-parent families.[6]

As families turn to the community for child care, they may be faced with a tiresome search for affordable, quality programs. The government has reduced some of its support for services to low-income parents. United Ways spend less than 5 percent of all their resources on child care. Parents' fees and contributions are the primary sources of revenues for the U.S. child-care system—a system that is often inadequate. Parents may use as many as four different arrangements each week, some of which may be of questionable quality. According to the Children's Foundation, (a non-profit advocacy organization in Washington, D.C.), an estimated 5 million children are cared for in family day-care homes—nearly 70 percent of which are unlicensed or unregulated. An unknown number of children are left to care for themselves. In the aftermath of several incidents of sexual abuse in child-care programs (in both day-care centers and family day-care homes) there is increasing concern about the quality of child care in this country. Efforts to improve quality will probably lead to an increase in the cost of care.

The insufficient supply of services creates two sources of pressure on employers:

- Parents bring their unmet child-care problems to the workplace.
- Community-based services, struggling for their own survival, look to the business community as a new source of support.

Employees are now more likely to raise the subject of their concerns at the workplace—in part because of increased opportunities offered by the company through quality circles, employee attitude surveys, counseling services, parent education seminars, and focus groups. At the same time, business is hearing from a new breed of employee, the "new values worker."[7] These are people who are becoming increasingly concerned about the quality of their lives, and who are more willing to express those concerns. In addition, the baby-boom generation has come of managerial age, but sheer numbers will prevent all who desire success from achieving it. With employees caught in this so-called "pyramid squeeze," employers may need to devise new benefits and rewards.

The new diversity among workers also demands flexibility in corporate policies.[8] Three of the more popular management initiatives under consideration are flexitime, flexible benefits, and flexiplace (work at home or telecommuting). Child care thus becomes another response to the concerns of an increasingly large segment of the changing work force. Through their attention to child care, corporations expect to solve some of their employees' family problems while furthering management's concerns for a dependable work force.

The Cost of Child Care

Raising children is an expensive undertaking. It cost approximately $2,500 to give birth to a child in 1982, according to the Health Insurance Association of America, and $140,927 to raise a child born in 1984 to age 18—nearly three times the cost of raising a child born in 1966.[9] A portion of that increase is explained by the growing need, or desire, to purchase child-care services. For working families, child care is the fourth largest budget item—exceeded only by food, housing and taxes. Child-care costs typically absorb 10 percent of a family's budget; for a family with two preschoolers, child care can amount to as much as 30 percent of a family's budget.[10]

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[4] See Helen Axel, *Corporations and Families: Changing Practices and Perspectives*. The Conference Board, Report No. 868, 1985; and, Children's Defense Fund. *Employed Parents and Their Children: A Data Book*. Washington, DC: Children's Defense Fund, 1982, p. 4.

[5] Motivations for corporate involvement in child care are more fully discussed in Dana E. Friedman, *Encouraging Employer Support to Working Parents*, Report for the Carnegie Corporation of New York, 1983. (Distributed by the Center for Public Advocacy Research, 12 West 37th Street, New York, NY 10018.) See also Renee Y. Magid, *Child Care Initiatives for Working Parents: Why Employers Get Involved*. New York: American Management Association, 1983.

[6] "Working Mothers Reach Record Numbers in 1984," *Monthly Labor Review*, December 1984, p. 31-34.

[7] Daniel Yankelovich, *New Rules: Searching for Self-Fulfillment in a World Turned Upside Down*. New York: Random House, 1981.

[8] See Harriet Gorlin, *Issues In Human Resources Management, 1985*. The Conference Board, Report No. 849, 1984.

The costs of child care vary according to the numbers and ages of children needing care, the type of care chosen, and the number of hours care is used. All of these factors are related to the income and education levels of the parents. One study suggests that 64 percent of all three- and four-year olds living in families with incomes greater than $20,000 are enrolled in some form of child care outside the child's home. Families with incomes below $20,000 are more likely to rely on relatives or family day-care arrangements, which are usually less expensive. Furthermore, 70 percent of parents with at least three years of college place their children in some part- or full-day child-care center. Informal arrangements, such as family day care, are used more often by parents with less education.[11] However, parents from all backgrounds seem to prefer family day care for their infants.

As evidenced by the data in Table 1, care for infants and toddlers (children under three years of age) tends to be more expensive than care for preschoolers (children aged three to five). Center-based care is typically more expensive than family day care, although care for an infant in family day care can be as expensive as—or more expensive than—care for a preschooler in a center. The least expensive programs are those serving school-age children (those six to thirteen). An in-home caregiver, unrelated to the child, is the most expensive form of child care: At $250 per week, child care would cost $13,000 per year, plus Social Security, unemployment and workers' compensation which increases the cost by 10 percent.

There are significant regional differences in the costs of care for children of various ages and for each type of care. For instance, it is most expensive to purchase child care in the Northeast, and cheapest in the South. As a result of these variations, out-of-home care for one child can cost anywhere from $1,500 to $10,000 per year, with the majority of parents paying $3,000 per year for child-care services.

Parents' Ability to Pay

According to *Forbes* magazine, the need for child care creates an estimated $10-billion a year service industry.[12] Parents pay approximately 70 percent of the costs of running these programs.[13] Like all goods and services, the cost of providing child care has risen. To ease the burden, most child-care programs offer reduced rates for enrolling more than one child. Sliding fee scales can help lower-income families afford program fees, but fewer than 10 percent of day-care centers vary their fees by income.[14]

In recognition of child care as a work-related expense, the Federal Government created a child-care tax credit in 1976 (See box, p. 8.) In 1982, over 5 million families received $1.5 billion in child-care credits (See Table 2). In 1983, child-care credits increased to $2.06 billion. As amended in 1982, a 30-percent credit may be taken by families with adjusted gross incomes of $10,000 or less. The credit is reduced by 1 percent for each $2,000 increase in income, and is limited to a 20-percent credit for those with incomes of $30,000 or more. The credit ranges from $480 to $720 for one child and from $960 to $1,440 for two or more children.

The credit may not be claimed against expenses in excess of $2,400 for one child and $4,800 for two or more. As indicated earlier, average costs exceed these amounts. In addition, the credit cannot be greater than the filer's tax liability.[15] As a result, many low-income families cannot take advantage of the credit. Only 15 percent of families using the credit in 1982 had incomes below $12,000. The Children's Defense Fund estimates that between a quarter and a third of eligible families applied for the Dependent Care Tax Credit.

Legislators, parents and child-care advocates have focused attention on the role of employers in making child care more affordable. One strategy for accomplishing this was embodied in Section 129 of the 1981 Economic Recovery Tax Act (ERTA), which authorized the creation of Dependent Care Assistance Plans (DCAP's). This provision made child care a nontaxable benefit for the employee and a tax-deductible contribution for the employer. Legislators anticipated that this provision would motivate employers to create voucher plans, through which employers' dollars are contributed to their employees' child-care costs, accord-

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[9] Health Insurance Association of America, *Cost of Having A Baby*. Washington, DC: Health Insurance Association of America, (1850 K Street, NW, Washington, DC 20006), 1984.

[10] W. Gary Winget, "The Dilemma of Affordable Child Care," in Edward F. Zigler and Edmund W. Gordon, eds., *Day Care: Scientific and Social Policy Issues*. Boston: Auburn House, 1982, p. 357.

[11] Sheila Kamerman, "Child Care Services: A National Picture," *Monthly Labor Review*. December 1983.

[12] John A. Byrne and Paul B. Brown, "Those Unpredictable Babies." *Forbes*, November 22, 1982.

[13] Winget, 1982.

[14] Roger Neugebauer, "Implementing a Sliding Fee Scale System for your Center," *Child Care Information Exchange*, Redmond, Washington, June 1984.

[15] Legislation to make the credit refundable may be introduced in the current Congress. The Senate supported refundability in 1976 and 1981, but the House opposed the measures because of concerns about revenue loss and questions about how helpful refundability would be to low income parents. In 1983, President Reagan proposed an expansion limiting eligibility to families earning less than $60,000. Several tax-reform proposals would eliminate the child-care credit entirely.

Table 1: Comparative Weekly Costs for Child Care in Seven Major Cities, as of January, 1985.[1]

	Family Day Care		*Day-care Center*			*Caregiver in*
City[2]	*Age*[3]	*Price*[4]	*Age*[3]	*Price*[4]	*School Age Program*	*Child's Home*
Boston	Under 2	$45-160	Under 2	$90-150	$30-40	$260-340
	2-5	40-160	2-5	75-110		
New York	Under 2	35-140	Under 2	60-150	20-60	165-300[5]
	2-5	35-140	2-5	50-120		
Atlanta	Under 2	30-60	Under 2	35-70	20-35	165-230
	2-5	30-55	2-5	30-70		
St. Louis	Under 2	45-50	Under 2	65-80	10-32	165 and up
	2-5	35-40	2-5	50-70		
Dallas	Under 2	50-70	Under 2	60-90	25-35	165-200
	2-5	50-70	2-5	50-70		
Denver	Under 2	65-105	Under 2	65-105	30	165-200
	2-5	55-105	2-5	55-105		
San Francisco	Under 2	55-90	Under 2	90-120	1/hr	165-200
	2-5	55-85	2-5	65-90		

[1] Source: Cost estimates were provided by staff of the following information and referral agencies: Child Care Resource Center (Boston); Child Care, Inc. (New York); Child Care Solutions (Atlanta); Child Day Care Association of St. Louis; Child Care Dallas; Mile High United Way Child Care Information and Referral (Denver); and the Child Care Switchboard (San Francisco).

[2] Costs will vary throughout the city; suburban child care may be more expensive and was not included in these estimates.

[3] For some programs, the fees increase after age 3. This table reflects the general cost difference between care for infants and preschoolers. Toddler care (age 2-3) is likely to be less expensive than infant care and more expensive than preschool care.

[4] Costs refer to full-day child care.

[5] The $165 weekly rate is the minimum wage ($3.35/hour). Some respondents acknowledged that this care might be purchased for as little as $2.00/hour or as high as $8.50/hour.

Table 2: Use of the Dependent Care Tax Credit, 1982

Adjusted Gross Income	*Number of Returns Claiming Credit*	*Percent of Total Returns Claiming Credit*	*Amount of Credit Received ($ thousands)*	*Percent of Credit Total Received By Income Group*	*Average Credit Amount Per Family*
Less than $5,000	10,702	.21	$ 963	.06	$ 89.98
5,000–9,999	280,328	5.60	73,676	4.91	262.82
10,000–14,999	581,065	11.61	210,194	14.00	361.74
15,000–19,999	642,705	12.84	203,165	13.53	316.11
20,000–24,999	772,760	15.44	221,213	14.73	286.26
25,000–29,999	649,448	12.98	176,069	11.73	271.11
30,000–39,999	1,124,671	22.48	320,477	21.34	284.95
40,000–49,999	604,349	12.08	184,486	12.29	305.26
50,000–74,999	274,891	5.49	88,324	5.88	321.31
75,000–99,999	37,068	.74	12,142	.81	327.56
100,000–199,999	21,923	.44	8,832	.59	402.86
200,000–499,999	3,351	.07	1,702	.11	507.91
500,000–999,999	269	.005	145	.01	539.03
Over 1,000,000	109	.002	65	.004	596.33
Total	5,003,639		1,501,453*		

Source: Prepared by Nancy Duff Campbell, Attorney, National Women's Law Center, Washington, D.C. from data provided by the Internal Revenue Service.

* Child-care credits claimed on 1983 returns rose 37% from this 1982 level to $2.06 billion.

Dependent-Care Tax Credit

The dependent-care credit is a way to deduct a portion of child-care expenses from federal income taxes. If the credit exceeds tax liability, it can not be refunded. The tabulation below presents the credit limits currently applied to various income levels.

Adjusted Gross Income	Percentage of Child Care Expenses to be Credited	Maximum Credits	
		One Child	Two or more Children
Up to $10,000	30%	$720	$1,440
$10,001–12,000	29	696	1,392
12,001–14,000	28	672	1,344
14,001–16,000	27	648	1,296
16,001–18,000	26	624	1,248
18,001–20,000	25	600	1,200
20,001–22,000	24	576	1,152
22,001–24,000	23	552	1,104
24,001–26,000	22	528	1,056
26,001–28,000	21	504	1,008
28,001 and over	20	480	960

Who Is Eligible?

- A parent who is employed (either full- or part-time) or is actively seeking employment, or is a full-time student at least five months of the year,
- Two-parent families, where both parents are gainfully employed,
- Parents with one or more children under 15 who are claimed as dependents,
- Parents who pay over half the cost of keeping up their home,
- A parent who is divorced or legally separated, even though he or she does not claim the child as a dependent. Children must be under age 15. The parent must have custody for more than half the year and pay for over half of his or her support during the year. Only one parent may take a child-care credit for the care of any child.

Expenses Covered

All child-care expenses that are necessary for enabling a parent to work, with these exceptions:

- Expenses are limited to $2,400 if there is one child under 15 and $4,800 if there are two or more children under 15.
- Expenses that are paid by another party, whether through a scholarship, a government allowance, or employer subsidy.
- Transportation costs between home and the child care arrangement.
- Expenses claimed may not exceed the annual earned income of a single parent or the annual earned income of the spouse with the lower income in a married couple.
- Selected child-care programs must comply with state and local licensing laws.

Payments to relatives qualify if they are providing care as employees of another organization, or as self-employed persons in their homes, or as the parents' employees for whom Social Security taxes are withheld. However, payments to relatives who are claimed as dependents for the tax year do not qualify.

How the Credit Is Claimed

The credit may be claimed on either the short form (1040A) or the long form (1040) of the income-tax report with Form 2441, "Credit for Child and Dependent Care Expenses" attached. Parents making claims must have receipts for child care fees. The credit may be spread over the year by having less tax withheld from pay.

ing to legislative staff members who were interviewed. However, as a nontaxable benefit, child care became a convenient addition to flexible benefit plans. Many of these plans involve a program of salary reduction but no employer contribution. Rather, in this type of plan, employees reduce their taxable income and use pre-tax dollars to pay for their dependents' care.

Parents still directly absorb the majority of child-care costs. Cost is thus a critical factor in the selection of a child-care arrangement. According to a national consumer survey in 1975, parents "purport to select care for child-oriented reasons over cost or convenience."[16] To the degree that consumers consider the quality and appropriateness of a child-care setting, many may find that they are unable to afford their preferred form of child care.

The Inability to Pay

There is little research on the effects of poor quality child care or the inability of parents to select their preferred form of child care. Yet, the scope and nature of these problems are emerging from child-care needs assessments conducted by employers. Further understanding comes from the anecdotes shared in parent-education seminars and counseling sessions at the workplace; from magazine and newspaper articles; and from testimony presented at congressional hearings.

For instance, when the affordable child-care choices are inconveniently located, parents may be forced to lengthen their morning commutes and run the risk of being late for work. Or, parents may need to leave work early in order to pick up children before centers close. On the other hand, the care might be convenient for the parent, but the child is unhappy, causing the parent to worry. If the situation warrants changing the child-care arrangement, the parent may require time off from work to visit other programs. In addition, the experience of experts in the field indicates that less expensive options may be of questionable quality.

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[16] Office of Child Development, U.S. Department of Health, Education and Welfare. *National Child Care Consumer Study, Volume III: American Consumer Attitudes and Preferences on Child Care.* Washington, DC, 1985, pp. 4-21.

When 60 to 80 percent of costs in a day-care center are designated for staff, cheaper care may have poor quality staff and high turnover. This frequently creates problems for the child and, ultimately, for the parent. Family day-care homes present a specific staffing problem: The parent may have to miss work if the provider is sick and has no back-up.

Some employers have felt the effects of problems associated with inappropriate child care. For this reason, a growing number of companies have begun experimenting with a variety of mechanisms that help ease the financial strain on the parents in order to facilitate their selection of more stable and better quality child-care arrangements.

Part 2

The Range of Financing Solutions

A significant amount of diversity and creativity characterizes the various child-care financing options. The program selected by an employer depends on three basic factors: (1) the level of financial commitment by the employer; (2) the special needs of parents in the work force; and, (3) the supply of child care in the community.

The options for corporate financial assistance for child care included in the survey and analyzed in this report include voucher programs, discount programs, and two types of flexible benefit plans. Other, less popular options are more briefly mentioned.

The financing options discussed below vary considerably in their cost to the employer and in their value to the employee. Only the discount program, which relies on a specific child-care vendor, limits the employee's choice. With most vouchers and all flexible benefit plans, employees are free to make their own arrangements, but satisfaction will depend on the availability of services in the community. In order for the value of financial assistance to be realized, employers sometimes provide additional funds to community programs to correct inadequacies in the child-care market.

Table 3 shows the prevalence of the various forms of financing options, the average amount of financial assistance gained by the employee, and the estimated expense per employee, to the company.

Trends in Employer Financing

Despite the variety of financing options and the uniqueness of each option once implemented, some patterns can be discerned among the group of employers providing financial assistance. Trends were observed in the types of employers involved, the extent of employee eligibility and utilization, and expected outcomes.

Child care—whether in the form of an on-site center or financial assistance—is concentrated in such high-growth industries as high technology and in the service sector, most notably banks, insurance companies, and hospitals.

Many of the larger corporations, able to afford the costs of studying and administering new benefits, have been in the forefront of the employer-supported child-care movement. The financing option is particularly attractive to large, multisite corporations because they can provide assistance in several locations. They are less likely to build numerous day-care centers to meet the needs of employees across the country. Small firms have been less involved in child-care provision until the advent of child care as a nontaxable benefit and the development of flexible spending accounts.

In most of these companies more than 50 percent of the employees are women. Yet, "female intensiveness" is not a prerequisite for involvement in child care. Procter & Gamble, for instance, has a 30-percent female work force, and American Can has only 25 percent. Measurex Corporation, which offers a voucher specifically designed to get women back to work after maternity leave, has a 37-percent female work force.

Only five of the thirty-eight companies responding were unionized. Unions have not been particularly active in child care, possibly because they do not have a presence among the fastest growing segments of the labor force: technical, white-collar, and women workers.

Eligibility

Companies almost always provide financial assistance on a companywide basis. Several firms had pilot tested their programs at their headquarters and then expanded them to other sites. The companies pioneering cafeteria benefit plans typically started the plan in one division to test reactions and fine-tune the administrative mechanism. In the few unionized companies in this sample, child-care assistance was not extended to union members. Approximately half of the responding companies offered the child-care benefit to part-time workers, prorating the value of the benefit according to the number of hours worked.

Utilization

Most companies found that less than 10 percent of the employee population took advantage of the financial assistance offered to cover child-care expenses. A variety of explanations may account for these low utilization rates. (No company had knowledge of the percent of *eligible* employees utilizing dependent care assistance. Several estimated that use by parent-employees was about 25 percent.)

Less than 40 percent of a typical employee population are

Table 3: An Overview of Various Financial Assistance Programs for Child Care

	Vouchers	*Discounts*	*Cafeteria Plans*	*FSA/SR*[1]
Estimated number of companies	25	300	75	500
Average amount of financial assistance to employee per year	$1,000	$500	$5,000	$5,000
Yearly cost per employee to the employer	$1,000	$500	$ 300	0[2]

These data were compiled from the surveys and estimates offered by consulting firms and child-care organizations.

[1] FSA/SR = Flexible Spending Account/Salary Reduction.

[2] The flexible spending account may involve an employer expense.

likely to have children. Some of these employees are part of dual-earning couples; others are single parents. Approximately 20 percent of these working families have children under the age of six. Furthermore, over 50 percent of parents with preschool children arrange for care by relatives.[1] If a personal deduction is claimed for these relatives, the number of working parents who have reimbursable child-care expenses may be further reduced. Given the marital status of employees, ages of children, and child-care arrangements selected, any work force may have fewer than 5 percent able to apply for dependent-care assistance.

There will be turnover among the employees requiring child-care assistance. As the need for child care ceases for some parents, because their children are older, other employees will bear children and need child care for the first time. While utilization may remain at 5 percent each year, the company is actually serving a larger proportion of the employee population over time.

The type of child care used by families may further inhibit their participation in a child-care assistance program. Certainly, in a discount program, only those employees approving of the specific vendor chosen will apply. All other financing options allow employees to choose their own arrangements. If parents choose an arrangement that does not meet the criteria for dependent-care tax credits (page 8), their child-care costs may be taxable and they may not participate in their employer's plan. Limited use of dependent care might occur in a flexible benefits plan if the parent must choose between dependent care and needed health care benefits. The forfeiture provision in the proposed IRS regulations may further reduce the selection of dependent care in a cafeteria plan. Forfeiture occurs when employees do not spend all of the funds in their accounts by the end of the year. A decline in utilization after complying with the proposed regulation was reported by three companies participating in this survey. Most of the employees interviewed felt that, despite low utilization, child-care users benefited greatly from the financial assistance offered.

Substantiating Claims

When employers help pay for the child care selected by the parent, they often require receipts from the provider before expenses will be reimbursed. Companies are limited by Internal Revenue Code Section 129 as to the acceptability of various child-care arrangements for nontaxable reimbursement. The required Dependent Care Assistance Plan (see Appendix) drafted by the employer must stipulate which programs are allowed.

Many employers and their legal counsel believe that it is the responsibility of the employee to assure that these criteria are met. Typically, the employer requires no more than a statement or signed affadavit from the employee as to the amount of child-care expenses incurred. Other employers monitor the use of the child-care dollars they provide more closely and require receipts, social security numbers, and the like, to assure that the child-care arrangement qualifies for nontaxable reimbursement.

According to the Wyatt Company, a benefit-consulting firm: "To the extent that the employer is providing nonqualifying child care, it is still deductible to the employer, but taxable to the employee. The employer is still involved because he is responsible for reporting and withholding income. Most of the employers we work with require employees to fill out a claim form to allow the employer to determine whether the care meets the requirements."[2] This difference of opinion will be settled when regulations on Dependent Care Assistance Plans are promulgated.

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[1] Martin O'Connell and Carolyn Rogers, "Child Care Arrangements of Working Mothers: June 1982." *Current Population Reports,* No. 129, November 1983.

[2] Cited in *Employers and Child Care: Development of a New Employee Benefit.* Bureau of National Affairs, Washington, DC, 1984, p. 16.

Expectations

Most employers providing financial assistance for child care expect that their investment will yield a return through improved recruitment, retention and productivity, and through lowered absenteeism and stress levels. This was particularly true for the companies offering vouchers, the option requiring the greatest investment of funds. The employers with comprehensive cafeteria plans indicated that productivity gains are expected from the restructuring of their benefit plans. It was not clear whether any additional outcomes were expected from the provision of a dependent-care option.

Child care is often marketed to the business community as a strategy for solving a range of management problems. It is clear from this and other surveys that many employers *believe* this connection to have some merit. Yet the research to date does not adequately substantiate these claims. None of the research has singled out the financing options, so that most conclusions are drawn from the experiences of employers (mostly hospitals) providing on-site day-care centers. On the basis of anecdotal evidence, the perception is confirmed, but no company has conducted the kind of research that would definitively answer the question.[3] This kind of research is difficult to conduct and often requires invasive questioning of employees. Many companies with child-care programs also offer a range of other family supportive benefits. It thus becomes difficult to attribute a change in employee behavior or attitudes only to the child-care component of their benefits and services.

The effects of child-care financing programs will ultimately depend on the availability of preferred forms of care and on the quality of the child care purchased. If that care arrangement is unstable, the employee may be absent or tardy. Some employers contribute to efforts to expand the supply or improve the quality of child-care services in addition to providing financial assistance to the employee. The unanswered question is whether the parents use the financial assistance provided by the employer to purchase better quality care, or whether they keep constant the amount spent on child care and shift their own resources to other household expenses. None of the surveyed companies have collected information that would answer these questions, and only five of thirty-eight respondents expressed an interest in conducting such research in the future.

Financing Options

Bearing in mind the overall patterns of response, the unique structures of each financing option are described below.

Voucher Programs

In a voucher program, an employer subsidizes a portion of the employee's child-care costs incurred at programs selected by the parent. The company may put the money in the employee's paycheck or pay the provider directly. This study identified fewer than 25 U.S. companies offering this direct form of financial assistance for child care.

The voucher program is less popular than other financing mechanisms because it can become an expensive option and it may serve only a limited number of employees. The amount of subsidy needs to be high in order for the parent to benefit from any meaningful reduction in child-care costs. Most companies limit eligibility to certain income groups or ages of children as a way to control the cost of a voucher program. For example, Polaroid Corporation covers a portion of the child-care costs for employees whose family incomes are less than $25,000. Measurex Corporation will pay for some child-care costs only during the child's first year of life. A company may also control voucher costs by limiting them to certain kinds of programs. For example, vouchers at Minnesota Mining and Manufacturing (3M) can be applied only to sick-child care programs; while at Baxter Travenol Laboratories, Inc. in Deerfield, Illinois and Palmetto General Hospital in Florida, usage is limited to a selected group of day-care centers. All employers with voucher plans set a maximum on the amount they will contribute to their employees' child-care costs—an amount based either on family income or cost of care.

According to child-care advocates, vouchers represent the greatest commitment to child care because they require a direct employer contribution. However, companies may be concerned about their potential cost while there is an attractive alternative—salary reduction—that offers employees similar savings at *no* cost to the employer. Smaller employers, unable to comply with salary-reduction regulations, may find vouchers attractive and affordable for a limited number of employees. Generally, however, widespread growth of voucher programs in the future is unlikely.

This conclusion was confirmed by The Voucher Project, a demonstration project conducted by the Phoenix Institute of Salt Lake City, Utah and funded by the Department of Health and Human Services. The project was designed to increase the number of employers offering child-care vouchers to their employees. The final report of The Voucher Project, 1984, explains:

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[3] Three national surveys of employers with child-care programs have attempted to gather information about the effects of child-care provision: Women's Bureau, U.S. Department of Labor, *Employers and Child Care: Establishing Services at the Workplace.* Washington, DC: U.S. Government Printing Office, 1982; Sandra L. Burud, Pamela R. Aschbacher, and Jacquelyn McCroskey, *Employer-Supported Child Care: Investing in Human Resources.* Boston: Auburn House, 1984; and, Renee Y. Magid, *Child Care Initiatives for Working Parents: Why Employers Get Involved.* New York: American Management Association, 1983.

Two experimental studies have attempted to show the productivity effects of child care provision: George Milkovich and Luis Gomez, "Day Care and Selected Work Behaviors," *Academy of Management Journal,* March 1976; and Ann Gilman Dawson, Cynthia Sirk Mikel, Cheryl S. Lorenz, and Joel King, *An Experimental Study of the Effects of Employer-Sponsored Child Care Services on Selected Employee Behaviors.* Washington, DC: Office of Human Development Services, Department of Health and Human Services, 1984.

A review of several studies appears in an article by: Thomas I. Miller, "The Effects of Employer-Sponsored Child Care on Employee Absenteeism, Turnover, Productivity, Recruitment or Job Satisfaction: What is Claimed and What is Known," *Personnel Psychology,* 1984, p. 277.

"Since the project did not provide matching funds as incentive for employers to try the voucher system, staff had a hard time selling the idea on its own merits. We concentrated our efforts on fairly large businesses—500 employees or more—who employ women at low salaries. We found that the businesses who seemed most receptive were the younger, progressive companies that were highly involved in computerized data networking or electronic technology. We received a wide range of responses to our presentations, but concern with expenses was most outstanding. We found employers who were genuinely sensitive to employees' needs, but didn't feel involvement in a voucher system was affordable."

Design of the Subsidy

The simplest approach to vouchers appears to be a flat-rate reimbursement provided to all employees, regardless of the cost of care or family income. To illustrate: Zayre Corporation in Boston reimburses its home-office employees up to $20 per week to meet child-care expenses. Fay's Drug Company in Liverpool, New York, provides full-time employees with "certificates of eligibility," worth $15 a week, toward the cost of child care.[4] Baxter Travenol Laboratories subsidizes child care at a rate of $3.50 per child per day for employees using one of two child care centers in the community. A three-year agreement between the *Village Voice,* a New York weekly newspaper, and District 65 of the United Auto Workers provides a $500-per-year child-care subsidy to employees with preschool children.

However, most companies base their vouchers on a fixed percent of total costs, establishing a maximum ceiling on the cost of care for which reimbursement may be received. For instance, Cambridge Plan International had a voucher plan in 1982 covering 50 percent of the cost of care, with limits of $80 per week for infant care (the company reimbursed the employee $40), $50 per week for preschool care, $35 per week for after-school care, and $20 a day for overnight care due to business-related travel.

Some employers may establish reimbursement rates in accordance with public-sector policies. When the Ford Foundation established its Child Care Assistance Policy in 1972, it paid 50 percent of the typical weekly rate paid by employees—with a small additional amount paid for those using licensed care, which is usually more expensive. By 1979, the reimbursement rates were no longer adequate and were changed to match the rates set by the New York City Agency for Child Development and the U.S. Department of Agriculture for care in Manhattan. According to the Ford Foundation's child-care policy:

"This new method of calculating reimbursement levels eliminates the necessity for frequent surveys of employee child care costs... Although the previous flat-rate reimbursement paid a larger proportion of the costs for those employees who chose the least expensive method of child care, the new reimbursement policy eliminates the inadvertant bias toward less expensive methods."

Another kind of voucher, with varying reimbursement rates, is related to family circumstances. The Polaroid Corporation offers a subsidy on a sliding scale, based on family size and income. The highest subsidy (80 percent of the cost of care) is paid to the lowest-earning employees, and the rate decreases to cover 10 percent of the child-care costs for families of four with incomes of $25,000 (Table 4). Polaroid defines its voucher program as a service, rather than a benefit, because of its targeted use for lower-wage-earning employees.

Eligibility

In small companies (described here as those with fewer than 500 employees), where a small number of employees are in a position to take advantage of the subsidy, eligibility is not usually limited. In larger companies, vouchers may be limited to those in greater need. Polaroid limits eligibility for vouchers to employees with family incomes of $25,000 or less. The Ford Foundation offers child-care assistance to full-time employees with gross family incomes of $25,000 or less. (The original income maximum of $20,000 was increased in 1980.) The income restrictions on eligibility help to keep overall costs low, but they prevent most professional staff from participating in the program.

Another goal for a voucher program—to reduce the amount of maternity leave taken by female employees—may also ultimately limit eligibility. At Measurex Corporation in Cupertino, California, a subsidy of $100 per month is available to employees during the child's first year of life. *Parents* magazine in New York offers a flat subsidy of $500 to be used during the first three months after childbirth. The intention here is to help new parents afford the high costs of infant care,

Table 4: 1984 Subsidy Rates for the Voucher Plan at Polaroid Corporation

	Number of Family Members		
Total Family Income	*2-3*	*4-5*	*6 or more*
$11,000	60%	70%	80%
13,000	50	60	70
15,500	45	55	65
17,000	40	50	60
19,500	35	45	55
21,000	30	40	50
23,500	25	35	45
25,000	20	30	40

Note: The amount of subsidy (which is provided on a sliding scale) is based on total family income and the number of members in the employee's family so that burdensome child-care expenses do not delay return to the job. Although the subsidy levels offered by these two employers are low when compared with an average infant-care cost of $100 a week, the program has been effective as an incentive to return from maternity leave. Professional employees are more likely to use this subsidy than are clerical employees, whose maternity leaves are typically shorter.

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[4] "Experiment With Vouchers in Onondaga County," *Business Link,* Fall, 1984, p. 6. Published by Center for Public Advocacy Research, New York, NY.

Eligible Services

Most companies allow vouchers to be applied to any child-care option covered by the child-care tax credit. Companies that are concerned about the quality of the programs their employees select may arrange for vouchers to be accepted by specific community programs. For example, Palmetto General Hospital in Florida pays 50 percent of the cost of care for employees enrolling in one of the several day-care centers that the hospital has evaluated and accepted for participation in the program.

Other companies target vouchers to specific aspects of the child-care problem. 3M inaugurated a pilot program in March, 1984, providing a subsidy for employees needing services for sick children. (The policy was made retroactive to January, 1984.) The subsidy may be used to purchase care provided by in-home health-care workers from Child Care Services, Inc., a program affiliated with St. Paul's Children's Hospital. Since most parents must continue paying for their regular child care when the child is absent due to illness, the costs of a separate, sick-child-care service increases the financial burden on the parent.

A study of care for sick children in the Twin Cities area indicated that the costs of in-home sick-child-care services range from $4 to $6 per hour—an additional cost to the family of $36 to $50 per day.[5] 3M employees pay only $2.00 an hour for sick-child-care services. The company made a one-year grant of $4,000 to Child Care Services, Inc. to cover the remaining $4.25 charged by the agency. This system does not require reimbursement by 3M. The company estimates that sick-child-care services will cost $10,000 in 1985 and will serve several hundred employees.

Utilization and Cost

Depending on the utilization and subsidy rates, the costs of voucher programs vary greatly among employers. The voucher is typically used by a small minority of employees, reflecting the demographic characteristics of the employee population or the eligibility criteria established by the company.

Since the program's inception at the Ford Foundation, the number of participants has never exceeded 28. This number represents nearly 10 percent of eligible nonexempt employees. In 1983, the total cost of the Ford Foundation's Child Care Assistance Policy for all users was $10,505, providing each parent with an average of $875 per year to cover child-care expenses.

Vouchers at the Polaroid Corporation, whose eligibility criteria are similar to those at the Ford Foundation, are used by a larger employee pool. Of 14,000 employees, an average of 100 employees have applied for vouchers each year since 1972, although this number fluctuates from year to year. At Measurex, 46 employees (or 4 percent of its 1,150 employees) have taken advantage of the voucher since the program's inception in 1975. An average of 14 employees per year use the subsidy for a period of nine to ten months after returning from maternity leave. The company estimates the costs to the company at $10,000 per year. The highest utilization rate was reported by Title Data Corporation of Colorado. One-quarter of its 100 employees (75 percent of whom are female) received a subsidy worth 50 percent of the cost of care in 1983. The company spends up to $18,000 per year on its voucher program, an average of $750 per employee per year.

Baxter Travenol Laboratories offers its subsidy to 2,000 employees working in the corporate headquarters area. Each year, approximately 70 employees have taken advantage of the $3.50 per day subsidy which saves the employees roughly $788 per year on their child care expense, and which costs the company approximately $55,125 per year.

As shown in Table 5, Cambridge Plan International had the most expensive voucher program. In 1982, over $100,000 was spent on 121 employees, serving 190 of their children. When the company needed to cut back on other services, it retained the child-care program because it felt that the employee and public-relations advantages outweighed the cost concerns.

Administration

Most companies provide the subsidy through a separate monthly payment to the employee. Prior to January, 1982, this amount was considered to be taxable income to the employee. For instance, in 1970, the employees at the Ford Foundation received reimbursement after deduction of the appropriate withholding taxes. The total expense of child care—both the Foundation's share and the employee's uncovered costs—could be claimed for the Child Care Tax Credit. After passage of the 1981 Economic Recovery Tax Act, however, the Ford Foundation drafted a Dependent Care Assistance Plan and offered the subsidy on a nontaxable basis and the Foundation's share could not be claimed for the tax credit.

The Polaroid Corporation is one of the few employers to pay the subsidy directly to the provider. According to the firm's Manager of Employee Services: "This decision was made by the Day Care Committee that designed the voucher and it has turned out that our employees prefer that we continue paying the provider directly." Payments are made on

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[5] "Sick Child Care Services Available in Metro Area," *NEXUS*, February 1984, p. 3. (Available from Greater Minneapolis Day Care Association, 1006 West Lake Street, Lehmann Center, Minneapolis, MN 55408).

Table 5: Features of Voucher Programs, Selected Companies

Company	*Title Data*	*Measurex*	*Polaroid*[1]	*Ford Foundation*[1]	*Cambridge Plan*	*Baxter Travenol*
Total number of employees	100	1,150	14,000	350	950	1,500
Percentage of female employees	75%	37%	58%	68%	58%	N.A.
Number of employees using plan	25	14	100	25	121	70
Percentage of employees using plan	25%	4%	Less than 1%	10%	13%	N.A.
Subsidy rate	50% of cost	$100 a month (for 1 year)	10-80% of cost	50% of cost	50% cost of care	$3.50/day
Average yearly cost per employee	$750	$900-1,000	N.A.	$875	$1,200	$788
Total yearly cost to employer	$14-18,000	$10,000	N.A.	$10,505	$120,000	$55,125

N.A. = No Answer

[1] Care provided to employees whose family incomes are less than $25,000.

a quarterly basis, but special arrangements can be made with centers that have cash flow problems.

For most employers surveyed for this report, payment to providers presents an unnecessary administrative burden. Some community groups have recognized this potential problem and have designed programs that facilitate employer provision of child-care subsidies. According to a report describing the Day Care Fund in New York City:

> "The Day Care Fund will serve as the 'Blue Cross' for child care, marketing a variety of child care plans to companies, and making third-party payments to service providers. This removes the administrative burden from the employer since the responsibility of the Fund is to assure program quality, establish subsidy rates and handle complaints. The Fund can help parents spend their employers' dollars more wisely through its provision of information services. For child care providers, the Fund would establish a centralized mechanism for integrating employer support, rather than forcing providers to cope with a variety of mechanisms that individual employers might establish."[6]

A similar program was established by the Greater Minneapolis Day Care Association (GMDCA) in conjunction with Parents in the Workplace. Their Employee Child Care Assistance Fund allows employers to contribute to the Fund and earmark moneys for their employees. However, no companies have taken advantage of this opportunity in either Minneapolis or New York City. This can be explained, in part, by corporate involvement in flexible benefits which does not typically require an outside administrative agency.

Other communities have had some success with this approach with smaller employers. For example, Austin Families Inc. in Texas offers this administrative service and currently operates child-care voucher programs for three employers: (1) Austin Independent School District Transportation Department, which covers 50 percent of employees' child-care costs; (2) Seton Medical Hospital, which pays $50 per month to families meeting income or family size guidelines; and, (3) Austin Regional Clinic, which covers 20 percent of child-care costs for employees with family incomes under $30,000 a year. The programs for the latter two began in early 1984 as part of a demonstration project with Community Development Block Grant funding and are not being continued by the employers with their own funds.

The Onandaga County Child Care Council administers the voucher program for Fay's Drug Company in upstate New York. The agency collects the vouchers from the child-care providers, pays them directly, and bills Fay's Drug on a quarterly basis.

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[6] Dana E. Friedman. *The Day Care Fund: Facilitating Employer Support for Child Care.* New York: Child Care, Inc. (125 West 109th Street, New York, NY 10025), 1983, p. V.

An Assessment of Voucher Programs

(Based on the experiences of identified companies)

Advantages

- Promotes parent choice.
- Supports community child-care services without selecting among deserving agencies.
- Limits administrative responsibility if paid through payroll deduction.

Disadvantages

- Can be costly, unless eligibility is limited.
- Limitations may cause equity problems.
- If community care is not available, or is not of high quality, then employer subsidies will not significantly address the more serious child-care problem facing employees.

A Corporate-Community Experience

As a result of state and local government experimentation with voucher programs, community agencies are already organized to extend services to the business community. Most of these agencies also provide information and referral services to help parents shorten their search for an appropriate child-care arrangement. Community Coordinated Child Care (4-C) of Central Florida receives state voucher money to cover a portion of child-care costs for low-income families. In 1978, McKinnon Corporation, a major citrus grower, was approached by 4-C because the agency found that public moneys were not always available for the corporation's employees during peak seasonal needs. The company had considered starting a day-care center, but realized that the farm workers would not be able to cover operating expenses. McKinnon Corporation agreed to cover 50 percent of the cost of care for any employees that 4-C could not help with public money. McKinnon Corporation then interested South-Lake Apopka Citrus Growers Association, a citrus packing house, to contract with 4-C in a similar arrangement. In anticipation of expanding this service to other employers, 4-C received IRS approval to create the Child Care Assurance Plan. Currently, six employers are contributing funds to 4-C to have it manage assurance plans for their employees.

In the Spring of 1984, 4-C contracted with two divisions of W.B. Johnston Properties: J.P. Hotels that manages Marriott and Holiday Inns, and North Lake Foods, Inc., franchisers of Waffle Houses, to provide the Child Care Assurance Plan to its employees. Both divisions run 24-hour-a-day operations and were faced with scheduling difficulties and employee absenteeism due to child-care problems. The success of the program in Orlando led to the expansion of the program to Atlanta, Jacksonville and Richmond and future plans to offer reimbursement in other parts of Florida and Virginia. (Only Florida has a state voucher system, so that where the program has been replicated in other states, there is no mechanism by which the community agency can allocate state funds to eligible employees before applying their employer's voucher funds. The agencies can advise employees to apply for government subsidy, but cannot distribute available state funds as Florida agencies can.) As explained by the Vice President of Organizational Development for J.P. Hotels and North Lake Foods: "This expansion was possible because 4-C in Orlando was able to identify local agencies that could replicate the Child Care Assurance Plan." This is the only instance we have come across of a multisite corporation that currently organizes a voucher program to serve employees in a variety of locations in different states. Several companies are considering the establishment of a national vouchering system to assist multisite corporations in this process.

As government agencies experiment with vouchers, and information and referral agencies proliferate, the opportunities for companies to provide vouchers, or other forms of financial assistance, will expand. In addition to eliminating the company's administrative responsibility and cost, these community agencies offer counseling services that can help parents become wise consumers of the day-care dollars made available by their employers.

Discount Programs

Many companies have negotiated reduced rates for their employees on rental cars, hotels and sports events for some time. In a similar manner, companies can now arrange for employee discounts at local day-care centers. An estimated 300 employers currently contract with a profit-making chain of centers or with a single, large center in the community. Most programs offer a 10-percent discount to the employee and, in about one-half of the contracts, the employer contributes 10 percent of the fees so that employees benefit from a 20-percent reduction in their child-care costs.

The discount approach is relatively inexpensive for the employer, because their contribution is limited to 10% of expenses or because there is no corporate contribution and, sometimes, because of limited use by employees. While employees may save between $250-$500 per year on child-care expenses, the centers available under the contract may be inconvenient for the parent, inappropriate for the child, or have no space for additional children. Vendors benefit from the discount program because they are able to fill unused spaces.

The Vendors

Most of the national day-care chains market some kind of discount program to employers. The experiences of three national chains interviewed for this study are described below:

- **Kinder-Care,** the largest chain with 900 day-care centers serving 95,000 children in 40 states, has 75 companies participating in its Kindustry discount program. As of late 1984, five companies also contract with Kinder-Care to run day-care centers for their employees' children (CIGNA Corporation, CT; Allendale Insurance, RI; Union Mutual Insurance

Corporation, ME; Campbell Soup, NJ; and, Walt Disney World [two centers], FL). Generally, companies participating in the Kindustry program match the center's 10-percent discount. Companies taking advantage of a payroll deduction option are billed the first of every month for 90 percent of the fees. Other companies are billed each month for their 10 percent contribution, and employees pay their portion of the fees directly to the center. Kindustry billing is coordinated at corporate headquarters in Montgomery, Alabama, and dispersed to individual regional offices where they have company accounts.

- **La Petite Academy,** the second largest chain of centers, has over 400 programs operating in 24 states. In all but four of its forty-seven regional divisions, children are enrolled in centers on the basis of the "Employer Care" discount program. The 155 companies working with Employer Care participate at no cost, but their employees receive a 10-percent reduction in fees. Approximately 1,000 families receive this discount.
- **Children's World,** a chain of 160 centers serving more than 20,000 children, offers a range of options to the 17 employers participating in its "Career Care" programs. In addition to the matching tuition reduction program, it also allows a variation for employers not ready to make a financial commitment. Through this "integration program," a 5-percent discount is offered to company employees for a period of six months in exchange for internal publicity about the program. During this time, Children's World closely monitors employee use and satisfaction. In some cases, the discount increases to 10 percent when the number of employees using the Children's World center reaches a predetermined level. In this way, the company has an interest in seeing that the program grows, which helps the centers increase enrollment. In one newly established center, the Career Care program has resulted in almost exclusive use by the employees of one company.

The discount program is typically provided by chains of centers because they can offer companies a choice of locations, enabling a greater number of employees to participate. The discount is offered exclusively by proprietary centers because they are likely to have the financial flexibility to reduce fees, and because nonprofit centers cannot guarantee a large number of spaces or show favoritism to any one employer. Vendors that offer discount programs are also likely to serve three-to-five-year-old children in an urban area because these are the programs that are most likely to be under-enrolled. The discount program is part of the center's marketing strategy and, as a result, an employer contribution is often not required.

The vendor's marketing strategy often involves encouraging parents who use the center to recommend the discount program to their employers. Employee endorsement stimulated a number of surveyed companies to enroll in the discount program. The vendors also provide promotional materials that are widely distributed throughout the company and assure additional publicity for the vendor.

According to the National Association for Child Care Management (NACCM), representing private, proprietary child-care-center owners and operators, the occupancy rate among its members is approximately 80 percent. The Executive Director of NACCM, explains:

> "Our members are building larger centers in high-growth areas, allowing population factors to serve as the driving force. These centers are built to accommodate community needs and are not designed to be 100-percent filled at first. There is the expectation that slower growth will produce a more stable program."

The three chains interviewed, as well as NACCM, expect continued growth in the number of employees participating in discount programs.

Participating Companies

Companies in the survey that offered discount programs are most likely to be financial institutions, hospitals or other service industries. They are also, typically, nonunionized and have high proportions of female employees. Employers with discount programs tend to be smaller in size than employers providing other forms of child-care assistance.

Among the 14 companies with discounts responding to The Conference Board's survey, the median company size was 950 employees, with a range from 3 to 3,400 employees (Table 5). According to the National Public Relations Director of Kinder-Care: "The *very* large companies are still holding out—there is so much red tape—but the medium and small companies are interested."

Equitable Life Assurance was one large company that tried the discount program on a pilot basis in three cities, but discontinued its involvement after two years of participation (see page 19 below). The 2,500 employees in Honeywell's Residential Division are eligible for discounts at a Children's World Center and two other centers in Minneapolis. And a fast-food chain with 11,000 employees offers discounts only to the 650 employees at its headquarters. A large, multisite corporation with a desire to offer some child-care benefit to employees in all locations is likely to find that a national contractor may not have a concentration of centers in needed locations. As a result, employee use may be severely limited or the company may need to contract with several providers.

Utilization of Programs

The number of employees using the discount program in any one company is typically low. Among the 209 companies participating in the discount programs of the three national chains described above, 2,259 children receive care under reduced fees. Parents may have more than one child enrolled, so that the actual number of *employees* who benefit from a discount program is even smaller. Kindustry estimates that, on average, 35 to 40 employees per company apply for the discount (ranging between one and 80 employees per company). Among nine companies with 100 employees or more responding to this survey, all but one employer reported utilization rates of less than

Table 6: Features of Discount Programs

	Fast Food Chain	*Phil Crosby & Associates, FL*	*Christian Hospital, MO*	*Olympia Fields Medical, IL*	*Brookwood Medical, AL*
Vendor	Kinder-Care	4C of Central Florida	Kinder-Care	Kinder-Care	Kinder-Care
Estimated Percentage of Utilization	2	3	4	2	2
Maximum Amount Available to Employee	10% of fees	50% of fees	$520 a year	No limit	20% of fees
Method of Distribution	Pay to provider, monthly	Pay to provider, monthly	Pay to provider, regular paydays	Employer portion paid to Kinder-Care headquarters	Pay to provider, regular paydays
Yearly Cost per Employee	N.A.	N.A.	$500	$100	$410
Total Employer Cost, Yearly	$1,500-$2,000	N.A.	$50,000	$2,000	$4,800
Total Number of Company Employees	11,000 (discount available to 650 at headquarters)	130	2,700	870	1,800

N.A. = no answer.

4 percent. The exception was a Florida bank with 112 employees, 15 percent of whom used the discount.

Since there is turnover each year among parent users, a larger group of employees eventually receives the benefit. One limitation of the utilization data is that none of the day-care chains contacted knew how many employees had tried to enroll their children but could not do so because the center was filled. There are also no data on the number of employees using discounts who switched their child-care arrangements in order to take advantage of a less expensive program. The low participation rates for discount programs may indicate that cost is not the most important criterion in selecting a child-care program.

Surveyed companies estimated that most of the discount users were female professionals. Fathers participated as often as mothers in three of the companies reporting. The large fast-food chain and the Florida bank were the only two of eleven employers reporting that said mothers in clerical positions constituted the largest user group. Among the five hospitals reporting that the discount was most frequently used by women in professional jobs, it is likely that the program was designed with nurses in mind.

Decision Making

Most of the employers responding to the survey indicate that the idea for child-care assistance came from an employee. An Illinois manufacturer with 750 employees was motivated by the personal problem of a manager. Apparently without employee urging, one hospital explained it "wanted to be proactive and not reactive."

All of the 11 employers with discounts and at least 100 workers conducted surveys to determine the scope of need and preferences for a solution. All but two first considered an on-site child-care center. One hospital, which closed its on-site center in favor of the discount program, explained: "We wanted a more effective center that was less costly." Another hospital is in the process of proposing that a seven-day, twenty-four-hour, on-site center be developed.

Expectations

Expectations of reduced absenteeism, better morale, and/or recruitment advantages apparently prompted most companies to respond to the child-care concerns of their employees. A majority of these employers said they would like to study the effects of the discount program in the future, but none had conducted, or is in the process of conducting, such research.

Three Company Experiences

Varied experience with the discount program and two of the national chains is reflected in the three cases studies that follow.

Honeywell, Inc. In July, 1980, Honeywell's Women's Task

Force at corporate headquarters published a study documenting a serious child-care need among employees. In March, 1981, a Working Parents Task Force was convened to develop solutions to the problem of working parents. The task force developed a list of 14 recommendations, including flexitime, parent-education seminars, and financial assistance for child care. Each division of the company was encouraged to consider adopting some of these programs for the parents it employs.

The Residential Division, employing nearly one-quarter of the Honeywell work force located in the Twin Cities, formed a task force similar to the corporate-level model. The effort was motivated by a group of young parents who were, according to a company spokesperson, "insistent, as well as good organizers." Their first project was to organize a Parent Fair, at which community agencies set up booths to display and discuss their services. They also designed a brochure for new employees, explaining all aspects of Honeywell policies that are family-supportive. The division's Director of Employee Relations became a staunch supporter of the task force after becoming a single parent.

While an on-site center was being considered, the task force was notified that a new Learning Tree day-care center (affiliated with the Children's World chain) was about to open one-half mile from the Honeywell division. One employee, whose child was enrolled at another Learning Tree center, endorsed the quality of the program, and a decision followed to contract for 60 slots at the new center at a 10-percent discount. If fewer than 60 division employees used the center, then the discount would amount to only 5 percent of weekly fees. Within seven months, more than one hundred employees at the Residential Division (approximately 4 percent) had enrolled their children in the Learning Tree center. Shortly after this, two other centers in the community began offering the discount to Honeywell employees.

Honeywell is currently considering a flexible benefits plan that would include dependent-care assistance, but the Residential Division plans to keep its discount arrangement with Learning Tree as well.

Company K—A Fast Food Chain. In early 1982, the child-care issue was raised at one of the company's semiannual employee meetings. A small group of managers met to discuss the suggestion, and decided to pursue it. A survey was prepared and circulated among the 650 employees at the headquarters office. Because space was at a premium, an on-site solution was abandoned. In looking into other options, one employee came forward to recommend a nearby Kinder-Care center. The Director of Employee Services believed that this employee was already using the center.

Company K decided to subsidize 10 percent of the child-care costs for those employees enrolling in any of the Kinder-Care centers in the area. Begun in June, 1982, and intended as a six-month pilot project, the discount was still available as of August, 1984. Approximately 15 of the company's employees use the discount. When asked about the low utilization, a company official explained: "Parents are satisfied with the quality of the Kinder-Care centers, but there are some needs these programs can't meet."

The discount program was developed on a pilot basis to determine whether it might be expanded to other facilities located in other parts of the country as employees outside headquarters have expressed their desire for child-care assistance. The Employee Relations Director remarked: "This is a continuing problem for the multisite employer. If you institute such a benefit, it could be more of a detriment than a boost if not offered companywide. You end up creating an 'us-them' environment." If the discount program is to be expanded, the company will consider using Kinder-Care in other cities. If Kinder-Care does not have a facility in certain locations, the company might consider providing a 10-percent subsidy and letting its employees choose their own child-care arrangements.

The Equitable Life Assurance Society of the United States. The subject of child care emerged during a meeting of a women's task force that used to meet regularly with the president. A Child Care Task Force, formed to investigate other companies' child-care programs, concluded in its final report in June, 1980: "The Equitable should encourage the growth and development of professional child-care services by lending its support as a corporate citizen."

Several options were considered, including a company-owned and operated facility and a voucher program. The task force favored a financing approach, because of "the potential long-term effects, the control Equitable could have over this type of program, and the potential for augmenting the good will of the community and enhancing company pride."

This recommendation led to a contract between the Equitable and Kinder-Care in March, 1981, establishing a pilot project in three cities with Equitable offices: Albuquerque, NM; Columbus, OH; and Atlanta, GA. Equitable employees could enroll their children in these centers on request. A 10-percent discount on child-care services was given by Kinder-Care. Equitable paid an additional 10 percent of the basic cost, and employee payments to Kinder-Care were made through payroll deductions.

The pilot was discontinued after 18 months. One of the chief concerns was the low utilization by employees—averaging a combined total of 25 per month at all three sites. Participating employees were very satisfied with the Kinder-Care centers, but some employees had difficulty changing their current arrangements. Part of the problem was that the program was launched at the end of the school year. Others were unable to afford the Kinder-Care program even with the discount. It was also realized that cost is not the sole basis of the parent's choice of child care. As an Equitable evaluation noted:

> "Even if the parent can afford Kinder-Care, many other factors, particularly location and perceived quality of care, are part of the decision-making process. Therefore, unless a Kinder-Care center is conveniently located and offers the type of care an employee wants, he or she may not choose to use Kinder-Care even if we offered up to a 50-percent discount."

An Assessment of Discount Programs

(Based on the experiences of identified companies)

Advantages

- Low cost. Many vendors do not require an employer match. A 10-percent match costs approximately $5 per week per employee.
- Little administrative responsibility. The only necessary administrative expenses are preparation of a written Dependent Care Assistance Plan (DCAP), promotion of the discount program, and development of a payroll-deduction system.
- Can expand with need. Additional slots can be guaranteed as more employees apply for the discount..
- Can retrench as need demands. The program can be discontinued or reduced with few administrative problems and little employee hardship..
- Limited liability, such as would exist with an on-site center.
- Favorable publicity, particularly as vendors promote their centers to the media and other employers.
- Good employee-community relations. This commitment is often seen as an investment in social responsibility.

Disadvantages

- Limits employee use. Only those who find the vendor's programs conveniently located or suitable for their children will enroll. This may create a problem of equity for employees with other types of child-care needs or preferences.
- Does not promote employee choice. The company, in choosing a vendor, is endorsing its quality. Some employees may disagree.
- Insufficient vendor capacity. Employees could be turned away or the vendor may not have facilities in all needed locations.
- Need for a written DCAP. Small employers may see this as an administrative burden.

In one of the pilot cities, low utilization was also attributed to the small numbers of employees and the limited number of Kinder-Care centers. Kinder-Care also felt that the Equitable did not adequately promote the discount option to its employees. In addition, there was a change in Equitable's management midstream and some cutbacks in Equitable services.

An Equitable manager observed the problem of collaborating with an organization operating on a different schedule. For instance, when Equitable instituted flexitime, the centers were unable to accommodate the varied schedules of employees. Another problem associated with a national vendor contract was the varied quality of programs at the local level.

After a total cost of $3,600 (or approximately $235 per employee), the Equitable concluded that if the benefits it "hoped to derive from this program are improvements in productivity, absenteeism, and so on, the conclusion would have to be that there is no evidence that these goals are being achieved." However, the company further concluded: "The short-term results show that Kindustry has been a relatively inexpensive benefit that has had a substantial public-relations impact." According to an Equitable Vice President:

> "The primary reason, then, for discontinuing the discount program centered on Equitable's desire to develop a service that would be equally accessible to our work force in hundreds of different locations across the country. It would have been virtually impossible to identify child-care providers nationwide with which we could then establish a program similar to what we had with Kinder-Care."

While the employees participating in the program still receive the discount as long as enrollment is not severed, the Equitable has moved to provide other types of child-care assistance. In December, 1983, a Child Care Information Service was launched that provides information to parents through a series of articles and taped presentations. Equitable is also engaged in a pilot project with Child Care, Inc. to provide information and referral services to employees in the New York City area. Management feels that even though it does not provide financial assistance, the information services it does provide can help parents learn to save money and choose quality care and make the best use of their day-care dollars.

Flexible Benefit Programs

A flexible benefit program, or "cafeteria" plan, allows employees to choose from a "menu" of taxable and nontaxable benefits those that suit their individual needs. The interest in flexible compensation stems from both social and economic change. The presence in the work force of women, two-earner families, single parents, and older and younger people—as well as changing and varying expectations of these groups—points up the problem of satisfying a diverse work force with one traditional set of benefits. The growing popularity of flexible benefit programs can be attributed to employers' desires to respond to diversity while controlling benefit costs.

There are many forms of flexible compensation, and each company seems to apply its own creative touch to the actual design of a particular model. According to several benefit-consulting firms, there were an estimated 600 flexible benefit programs in place at major corporations in late 1984, and between 50 and 75 percent of them include dependent care as an option.

History

Most flexible plans have been implemented since 1982. Although TRW, Inc. and Educational Testing Service (ETS) pioneered flexible benefits in the early 1970's, widespread growth was inhibited by the absence of definitive rules on the doctrine of "constructive receipt": With passage of ERISA (Employee Retirement and Income Security Act) in 1974, Congress banned all kinds of benefit plans permitting choice. If an employee was given a choice between taxable and nontaxable benefits or cash, the employee was in "constructive receipt" of the benefit and, therefore, the value of all benefits—even those that were nontaxable—would have been subject to taxation.

This doctrine of constructive receipt was reversed in the Revenue Act of 1978. As a result, a choice of benefits could be offered and no tax would be imposed on the nontaxable benefits selected. While Section 125 of the Internal Revenue Code made it clear that a choice of benefits was allowed, many employers stayed away from flexible compensation because of the absence of Internal Revenue Service regulations providing guidelines for the design of such benefit plans. The regulations finally proposed in May, 1984, proved to be controversial. The novelty and administrative complexity of flexible benefits have further inhibited the growth of these plans.

Another change in the tax law brought child care into the debates on flexible compensation. In the Economic Recovery Tax Act of 1981, (ERTA), dependent care was made a nontaxable benefit, and, thus, a convenient option to include in flexible plans. One of the factors inhibiting the growth of employer-supported child care has been employer concerns about equity. Employers are concerned that employees without young children would feel they should receive a benefit of equal value. Since flexible benefits became legal, and child care was deemed a nontaxable benefit, financial assistance for child care has grown along with flexible plans. (See box, p. 23.)

The Structure of Flexible Plans

There are a variety of ways to offer a choice of benefits to employees while containing—or reducing—benefit costs for the employer and providing more tax-effective compensation to the employee. For the purpose of understanding how dependent care becomes an option in a flexible plan, the various alternative plans are grouped into two categories of flexible compensation. The first category includes the more comprehensive approach to benefit planning—where the basic package of benefits has been redesigned and employees have use of flexible credits to purchase desired benefits. Credits are usually generated by employer contributions and are placed in a credit account for the employee. Among 100 so-called cafeteria plans surveyed by Hewitt Associates, 86 had a flexible spending account. Of these, 74 percent offered dependent care as one of the benefit choices.[7]

The second category of flexible compensation surveyed and analyzed for this report is the free-standing, flexible spending account. The basic benefits package is unaltered, but a spending account is available for a variety of taxable and nontaxable benefits. The account may include an employer contribution, but is usually funded by salary reduction. Some employers also allow the value of unused vacation days or a portion of savings and profit-sharing plans (401[K]) to be applied to the flexible spending account. According to estimates by national benefit consultants, as many as 1,000 employers—including major corporations, small professional firms, municipalities and other nonprofits—provide flexible spending accounts. They further estimate that 50 to 75 percent of these plans include dependent care.

Dependent care in a cafeteria plan can only be funded through a flexible credit system or spending account. Therefore, all cafeteria plans with dependent care have established some kind of flexible spending account, which may or may not be funded through salary reduction. The purpose of distinguishing the comprehensive cafeteria plans from stand-alone, flexible spending accounts is to highlight the differences between management's goals and administrative complexity. For instance, the comprehensive plan requires a complete overhaul of the benefits package, and may be a far more complicated endeavor than establishing an account and adding new benefit options to the standard benefits package. The experiences of the surveyed companies that provide either a comprehensive cafeteria plan or a stand-alone flexible spending account are described below.

Comprehensive Cafeteria Plans

Hewitt Associates estimates that 75 major corporations offer dependent care as an option in their flexible benefits programs. The Employers Council on Flexible Compensation (ECFC) estimates that the number would increase to over 500 employers if medium-sized companies were included.

The core program in a flexible benefits plan typically consists of the following benefits:

- health insurance,
- life insurance,
- disability insurance,
- vacation,
- retirement income.

Less frequently, core benefits include tuition assistance and capital accumulations (savings and profit sharing). Procter & Gamble includes adoption assistance in its core package.

Optional benefits that are nontaxable by law, which may be purchased with flexible credits, include:

- dependent care,
- unreimbursed medical expenses,
- unreimbursed dental expenses,
- unreimbursed vision and hearing expenses,
- legal services,
- financial planning,
- deferred savings [i.e., 401(K)] plan.

The number of flexible credits almost always depends on an employer contribution plus a proportion of salary, qualified by length of service. Some formulas are more complicated than others. For instance, American Can's flex credits are computed as follows: $900 employer contribution + 1 percent of pay + $10 for each year of service. Procter & Gamble contributes between 2 and 4 percent of pay, based on length of service. Generally, the credits are received in separate payments

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[7] Interview with Linda McFarland, Benefits Manager, Hewitt Associates, September 1984.

Requirements of Dependent Care Assistance Programs (DCAP)[1]

Employer Requirements

Written Plan: The employer must prepare a separate written plan for the DCAP. The program must be for the exclusive benefit of its employees in providing employees with dependent-care assistance.

Anti-Discrimination Rules: The program must not discriminate in favor of employees who are officers, owners, or highly compensated, or in favor of the dependents of these employees. Members of a collective-bargaining unit may be excluded if dependent-care benefits have been the subject of good faith bargaining between the employer and the union but were not included in the union contract. No more than 25 percent of the amount paid for dependent-care assistance may be paid on behalf of individuals who own more than 5 percent of the stock of the employer if it is a corporation or if they own more than 5 percent of the profits or capital interest in an unincorporated employer.

Notification: The employer must notify eligible employees of the availability and terms of the program.

Statement: The employer must give the employee a written statement showing the amounts paid or expenses incurred by the employer in providing dependent-care assistance. This statement must be received by January 31st following the year in which expenses were incurred.

Federal Taxes: The amounts paid under this program are excluded from consideration with respect to federal withholding, social security, and unemployment tax.

Funding the Program: The employer must either establish a fund or pay the costs as they arise.

Employee Requirements

Earned Income Requirements: No employee may exclude from income an amount larger than the amount earned during the year. Thus, for example, if a part-time employee earned $4,000 and received a child-care benefit of $5,000, the employee would have to pay tax on the $1,000 difference.

In the case of married employees, the excluded income can not exceed the earned income of the lesser earning spouse. For instance, an employee with a nonworking spouse does not qualify for the DCAP and will have to pay tax on the total value of a child-care benefit. However, a spouse who is a full-time student for at least five months during the year, or who is disabled, will be assumed to have earned $200 per month if there is one child, or $400 per month if there are two or more children. Consequently, a student or disabled spouse may accrue up to a maximum of $2,400 or $4,800 worth of excludable income and thereby qualify the employed spouse for the DCAP.

Relationship to Child Care Tax Credit: Subsidies or services received through a DCAP are not subject to the child-care tax credit. However, if an employer subsidized only part of an employee's dependent-care costs, the employee may take the child-care tax credit on the unsubsidized portion.

Provider Requirements

The caregiver may be any person except one for whom the employee or the spouse of the employee is permitted to take a personal exemption, or a person who is the employee's child under the age of 19. Thus, typically, the caregiver cannot be the employee's spouse or a teenage sibling of the cared-for children.

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[1] Reprinted with permission from Kathleen A. Murray, Attorney at Law, Child Care Law Center, San Francisco, CA "Employer-Supported Child Care Receives a Boost: Dependent Care Assistance Programs," 1983. See Appendix A for sample DCAP.

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or the amount is included in the employee's paycheck. The frequency of payments varies from bi-weekly to monthly to quarterly. At American Can, credits are generated each pay period based on the credit formula and are then portioned out according to the schedule selected by the employee on the flexible benefit enrollment form.

Eligibility

There are no salary limits placed on eligibility for flexible benefits. In fact, the purpose of flexible benefits is to provide *all* employees with a benefits package of comparable value. However, only salaried employees are included in the plan in several partially unionized companies, since benefits are negotiated separately for union members. For example, American Can is 36 percent unionized in its domestic operations, and only salaried employees in the headquarters and packaging plants are eligible for participation in the flexible plan. P & G is 25 percent unionized, and only monthly salaried employees and nonmanufacturing, weekly salaried employees receive a choice in benefits through the company plan. A separate plan containing essentially the same benefits has been established at a nonunion manufacturing location for hourly and weekly salaried employees.

Some employers require that employees must work for the company for a specified period of time before they are eligible to participate. One year of employment is required by Cleveland Clinic and, depending on the date of hire, P & G employees are not eligible for a period of 18 to 30 months. Among the six companies with flexible benefits responding to the survey, only ETS allows regular part-time employees to participate in the flexible plan and prorates credits according to the hours worked.

Most companies follow the requirements defined by Section 129 of the Internal Revenue Code with regard to the application of dependent-care benefits: Licensed centers, family daycare homes, and in-home babysitters are covered for the hours of child care needed in order to work. Dependent-care credits may also be used to care for elderly parents and disabled dependents. (See box, p. 8.)

Utilization

A relatively small proportion of employees take advantage of dependent-care assistance in flexible benefit plans. Of the major corporations surveyed, the utilization rates ranged from 2 percent at ETS to 7 percent at Comerica. Dickinson College, with 465 employees of whom 40 percent are females, finds 6 percent of its employees selecting dependent care in their package of benefits in the first part of FY 85. This represents a marked decline in use since compliance with the forfeiture provision proposed in Section 125 regulations. Approximately 5 percent of the P & G population choose dependent care, but this figure represents 25 percent of eligible employees with children.

The distribution of use varies among companies as well. All but two of the responding companies report that the dependent care benefits are used equally among clerical and professional workers. Companies indicate that mothers appear to select the dependent-care benefit more often than fathers: Only P & G could document that a substantial portion of men select dependent care—50 percent of the users of dependent care were men, although two-thirds of flexible benefit program participants are men.

In most companies, employees are allowed to spend the total value of their flexible credits on child care. From the few companies responding to the survey, parents appear to spend from $700 to $3,000 of their credits per year when selecting the dependent-care option.

Cost to the Company

Companies assume the costs for designing, implementing and administering a new flexible system. Ongoing, administrative costs for ETS and Cleveland Clinic were about $30,000 per year in 1983. According to Hewitt Associates, most of the major corporations with cafeteria plans provide some direct employer contribution to the flexible credit account. This amount ranges from $100 to $1,000 per employee and is typically $300. None of the employers specifically designates contributions for dependent-care expenses. With the exception of the legal fees required to prepare a Dependent Care Assistance Plan, employers do not incur any extra cost for including child care in a flexible plan.

Planning

A number of companies with the dependent-care option in their cafeteria plans have considered alternative ways to address the child-care issue. In such firms, the need for child-care assistance surfaced prior to, or independent of, the introduction of flexible benefits. To illustrate: ETS learned of staff interest in an on-site day-care center before it added dependent care to its flexible program. At Procter & Gamble, a human-resource manager was working with a consultant studying and designing child-care solutions independent of the decision to provide flexible benefits and establish a dependent-care option.

The majority of employers, however, learned about their employees' child-care needs while designing their flexible benefit plans. In surveys and focus groups designed to elicit employees' needs, child care would emerge as a preferred benefit option. Companies did not respond to this identified need until passage of the 1981 tax legislation, when dependent care was made a nontaxable benefit. Thus, ETS' cafeteria plan, begun in 1974, did not include dependent care until 1982; American Can had its plan in place four years before dependent care became an option.

Flexible Benefits in the Public Sector

Only a handful of government agencies have implemented flexible benefit plans for their employees, yet interest is growing. Benefit plans in the public sector are typically rigid, offering less choice than private-sector employers. Public-sector plans are also highly contributory, and in some instances, due to expensive pension plans, may be more costly than those in the private sector. According to Robert Kalman of William Mercer-Meidinger, Inc., an employee benefits and compensation consulting firm, they are "ripe for development."

An administration official in the State of North Carolina further observed that: "State government is often the largest employer in the state. It is also likely to be a growth area for unionization. Pressure may increase for individualized benefits and, as a result, flexible benefits may become a bargaining item in a growing number of states—particularly those that hope to serve as a role model for private sector employers."

North Carolina's state government is contemplating provision of flexible benefits. Catawba County, North Carolina, has already implemented a flexible plan that includes a flexible spending account with a dependent-care option. Salary reduction is allowed up to 10 percent of pay. Annual reimbursement for child-care expenses is limited to $5,000.

Expectations

Most companies believe that they will be able to control or reduce benefit costs by offering choices through a cafeteria plan. They also hope to engender greater loyalty from employees who are more satisfied with their benefits.

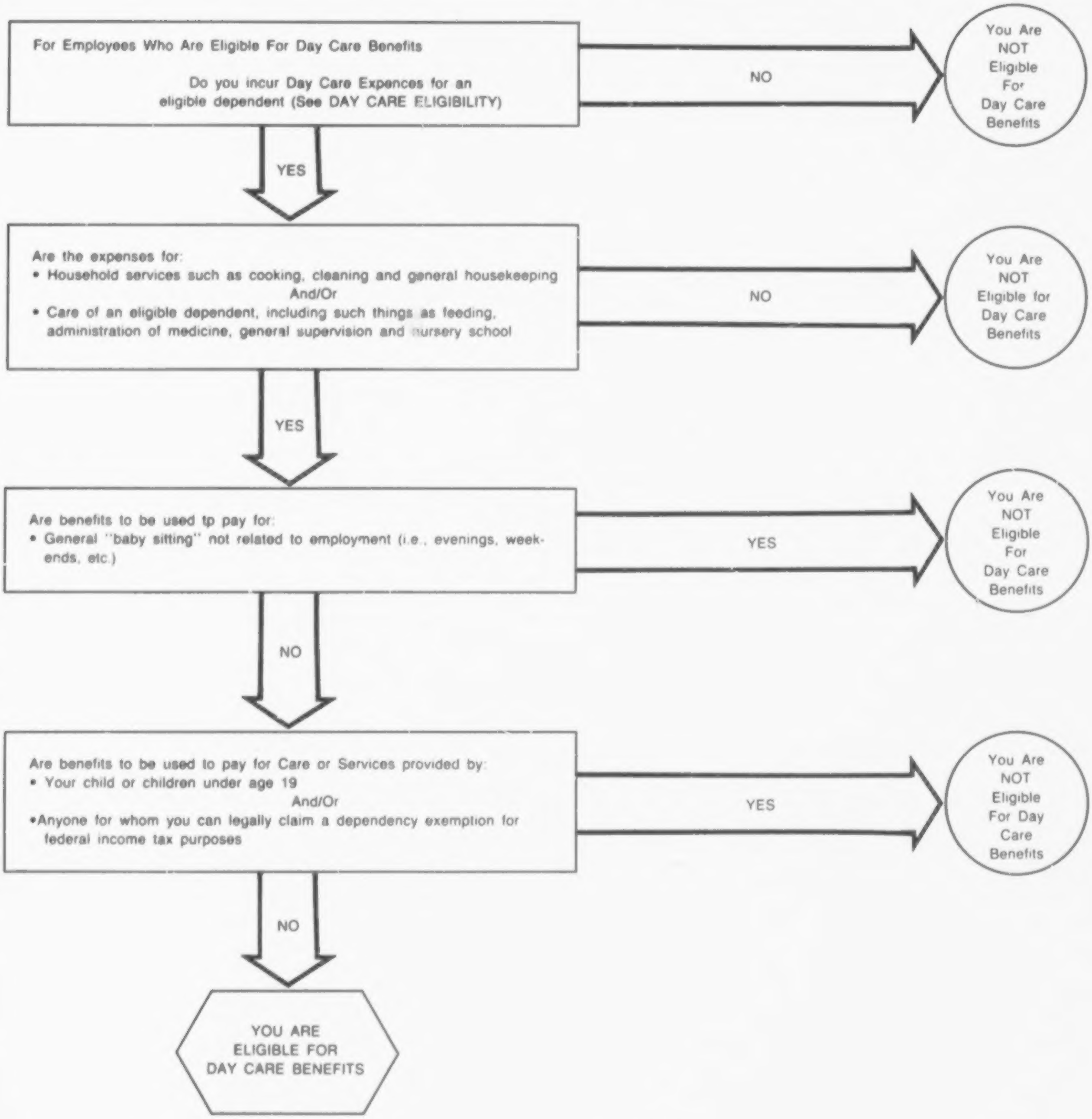
In a survey conducted by American Can in 1982, 74 percent of employees rated the benefit program "good" to "excellent," compared with a norm of 56 percent for other companies. In a separate study, Hewitt reports that three of ten employers that have completed a financial analysis of their flexible programs, found that flexibility reduced benefits costs; five indicated that flexibility contained benefit-cost increases; and two reported no cost savings.[8]

Employers surveyed for this report indicated that they expected additional returns from the inclusion of dependent-care assistance. Most employers predicted that their attention to child care would help them attract and retain employees, reduce stress, and increase productivity. No company had data to substantiate these claims, nor were any planning to collect such data in the future.

[8] Hewitt Associates, *On Flexible Compensation*. New York: July 1983, p. 4.

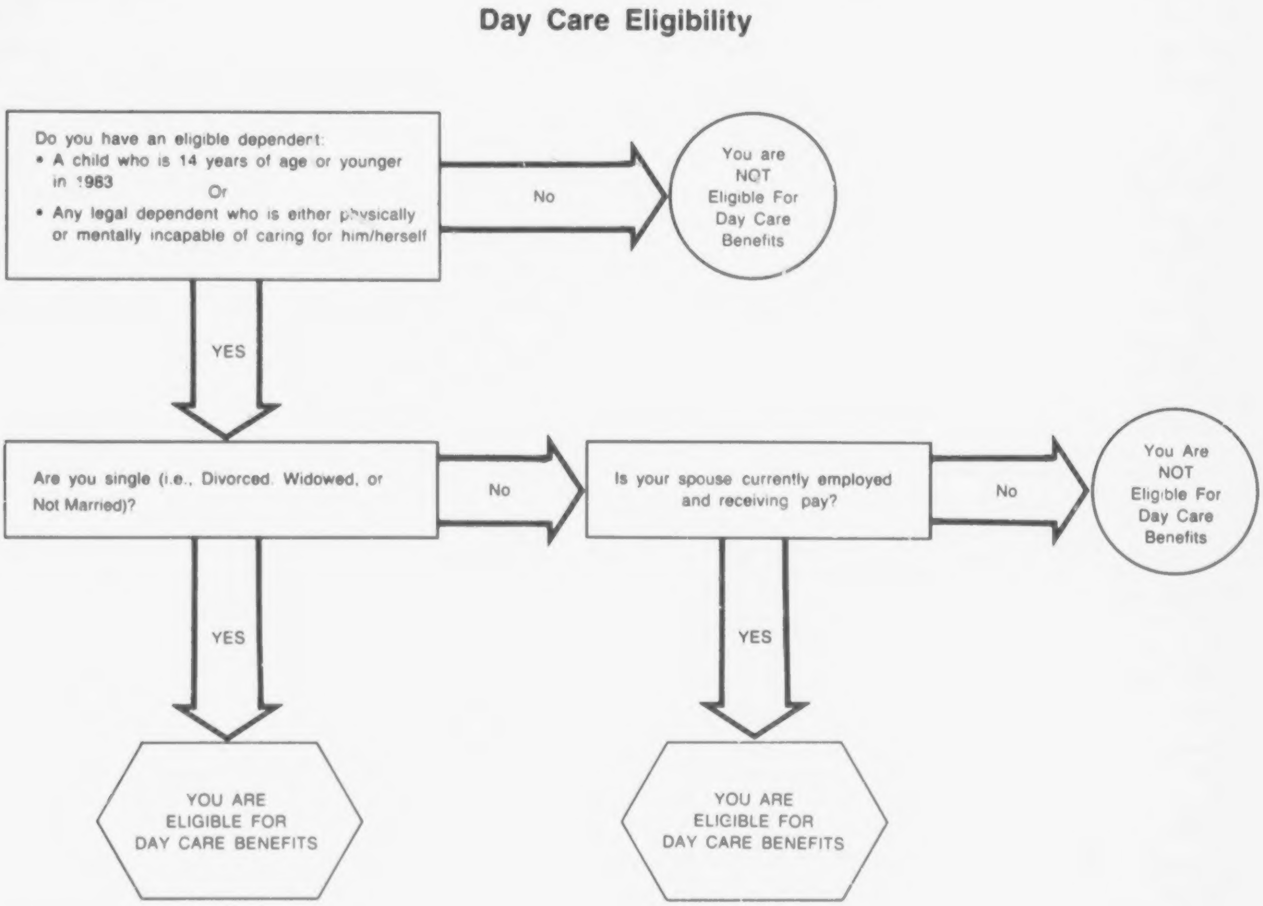
Chart 1: Eligible Expenses

Eligible "Employment Related Expenses"


For Employees Who Are Eligible For Day Care Benefits
Do you incur Day Care Expences for an eligible dependent (See DAY CARE ELIGIBILITY)
NO
You Are NOT Eligible For Day Care Benefits
YES
Are the expenses for:
• Household services such as cooking, cleaning and general housekeeping
And/Or
• Care of an eligible dependent, including such things as feeding, administration of medicine, general supervision and nursery school
NO
You Are NOT Eligible for Day Care Benefits
YES
Are benefits to be used tp pay for:
• General "baby sitting" not related to employment (i.e., evenings, week-ends, etc.)
YES
You Are NOT Eligible For Day Care Benefits
NO
Are benefits to be used to pay for Care or Services provided by:
• Your child or children under age 19
And/Or
•Anyone for whom you can legally claim a dependency exemption for federal income tax purposes
YES
You Are NOT Eligible For Day Care Benefits
NO
YOU ARE ELIGIBLE FOR DAY CARE BENEFITS

Source: American Can Company

Chart 2: Day Care Eligibility


Day Care Eligibility
Do you have an eligible dependent:
• A child who is 14 years of age or younger in 1983
Or
• Any legal dependent who is either physically or mentally incapable of caring for him/herself
No
You are NOT Eligible For Day Care Benefits
YES
Are you single (i.e., Divorced, Widowed, or Not Married)?
No
Is your spouse currently employed and receiving pay?
No
You Are NOT Eligible For Day Care Benefits
YES
YES
YOU ARE ELIGIBLE FOR DAY CARE BENEFITS
YOU ARE ELIGIBLE FOR DAY CARE BENEFITS

Source: American Can Company

Two Company Experiences

Dependent care as part of a comprehensive cafeteria plan is illustrated by two companies with different lengths of experience: One has recently instituted its plan; the other is considered one of the pioneers in the flexible benefits field.

Procter & Gamble. The Procter & Gamble Company has 10,000 of its 17,000 management and nonplant, weekly salaried employees headquartered in Cincinnati, Ohio. Approximately 30 percent of this headquarters work force is female. Management observed the increase in the number of workers belonging to dual-earner families. A limited flexible benefits program including only IRA and cash was implemented for the salaried employees of the company in 1982. In 1983, the flexible benefits program was expanded to include several nontaxable benefits as well. Concurrently, a Child and Dependent Care program was established, to which company contributions not used for flexible benefits could be directed. At the time, the provisions of Internal Revenue Code Section 129 were understood to require that dependent care could only be provided under a separate plan.[9] As a result of the proposed IRS regulations for Section 125 of the Code, dependent care will be included in the P & G flexible benefits program in 1985.

The company contributes 2 to 4 percent of an employee's pay which can be applied to optional benefits including vacation, cash, dependent care, unreimbursed vision and dental expenses, and up to $400 in life insurance premiums. Approximately 5 percent of employees apply their credits to dependent care, accounting for 3 percent of total credits used. A benefits officer explained that while the 5 percent utiliza-

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[9] Unlike other statutory provisions governing employee benefits, Internal Revenue Code Section 129 authorizing dependent care requires a separate written plan—but reimbursement *can* be made along with other benefits.

Table 7: Features of Cafeteria Plans

	Educational Testing Service	*American Can*	*Procter & Gamble*	*Comerica*	*Cleveland Clinic*	*Dickinson College*
Core Benefits	Health, life, disability, vacation, retirement, holidays, personal time, tuition assistance, educational allowance	Health, life, disability, vacation, retirement, adoption	Health, life, disability, retirement, capital accumulation, tuition, adoption assistance, profit sharing	Health, life, disability, vacation	Health, life, short-term disability, paid time off, retirement, tuition assistance	Health, life, disability, vacation, retirement
Source of Flexible Credits	3 to 6% of salary based on years of service	$900 + 1% pay + ($10 × years of service)	2 to 4% of pay based on years of service	Age, seniority, pay	Percent of pay from employer, trade-in paid time off	5% salary + 5% college contribution + cost of employer share in insurance, $2,000 salary for health
Optional Benefits	DCAP, retirement, medical, life, dental, vacation, mutual funds, physical exam, dependents' life insurance, cash	DCAP, medical, dental, life, disability, capital accumulation, vision, hearing, preventive health, financial planning	DCAP, vision/dental, life, vacation, cash. Cash may be used for dependent life, financial planning	DCAP, medical, life, disability, vacation, capital accumulation, AD&D, dependents' life, health care, cash	DCAP, dental, life, long-term disability, tuition, vision, prescription drugs	DCAP, retirement, medical, dental, life, capital accumulation, vacation, legal
Method of Distribution	Separate payment to employee or provider, semi-monthly or as bills are submitted	Employees' accounts in the options they elected on regular paydays	Separate payment, quarterly of vision/dental reimbursements to provider or employee (semi-annual)	In the paycheck, bi-weekly	Separate payment as bills are submitted	Separate payment, monthly
Utilization of DCAP	2%	1%	5%	7%	1.5%	6%
Yearly per Employee Cost of DCAP	$3,000	$700	$500	$1,800	N.A.	N.A.
Cost to the Company for DCAP, Yearly	$30,000	$26,000	$400,000	Administrative expense only	N.A.	Administrative expense only
Total Number of Company Employees	2,300	26,000	45,000	6,000	7,500	465

N.A. = no answer.

tion appears low, it actually represents about 25 percent of eligible parents in the P & G salaried work force. Most of these parents are younger, shorter-service employees.

Unconnected to the planning and provisions of dependent care in a flexible plan, a consultant was hired to analyze employees' child-care needs and the community resources to meet them. A three-pronged strategy was proposed, and was accepted by management in 1983.

The first recommendation suggested that P & G provide seed money and technical assistance for the creation of a child-care resource and referral service housed within the Cincinnati Community Coordinated Child Care Agency. This program began in the Summer of 1984. The second idea addresses the needs of parents with school-age children. Efforts are under way to improve the quality and quantity of these services. Finally, the third recommendation led the company to provide start-up funds for two day-care centers in which P & G employees will have priority in 75 percent of the spaces. One center opened in the Fall of 1984, the other began serving families in January, 1985. The job of Manager, Child Care Services, was created to coordinate these various child-care initiatives over a two-year period.

These community-related initiatives, however, are separate from the company's provision of dependent care within the flexible benefits program. A benefits officer explained that the benefit strategy was not designed to solve the multitude of problems related to child care. "We were simply trying to help parents through advantages provided in the tax code. We demonstrated our interest in child care with a very quick response. The other child-care services required a lot of planning and involved the creation of new resources—resources that help our employees use the dollars we make available through our flexible plan." Among the programs in the study, P & G represents one of the most comprehensive corporate responses to child care in the country.

Educational Testing Service (ETS). ETS was one of the pioneers in the flexible benefits movement. It restructured its benefits package in 1974, and has continued adding new benefits as employee needs are identified. Dependent care, for instance, was added to the flexible benefits plan in 1981, after an investigation into other child-care alternatives and a change in the tax laws.

The core of the ETS flexible benefits package consists of health insurance, life insurance, temporary and total disability insurance, paid vacation, a retirement-income plan, personal time off, tuition aid, and an educational allowance. Flexible credits are company funded, and employees receive 3 to 6 percent of base salary, based on years of service. Credits may be applied to the following optional benefits: dependent care, retirement, medical coverage for dependents, dental coverage, life insurance (for employees and dependents), four major mutual fund companies and cash. Employees must incur expenses before the semi-monthly reimbursement is made for dependent care. All 2300 ETS employees, working in eight locations around the country, are eligible to participate. Regular staff working part-time are included in the program, although their flexible credits are prorated on the basis of the hours worked.

While the new system came into effect in the early 1970's as a way to control benefit costs and recruit a talented work force, child-care issues emerged from another area of concern. In 1980, a women's committee recommended that a day-care center be established at the headquarters office. An employee survey was conducted indicating an interest in a center, but the beneifts department eventually rejected the idea. It was concerned about the initial start-up costs (which were estimated at $500,000), low utilization, liability risks, and employees taking too much time away from work to be with their children during the day. As the center proposal was being rejected, Congress had just passed the Economic Recovery Tax Act, which made child care a nontaxable benefit. The benefits department concluded that employees would utilize child-care reimbursements included as an option in the flexible benefits plan.

The 1980 survey of child-care needs indicated that 300 employees might use an on-site center. However, ETS has found only 48 employees, or approximately 2 percent of the work force, electing dependent-care coverage in the flexible benefits plan. (Fewer than five of these employees apply dependent-care credits to the care of their elderly parents.) ETS attributes low utilization of the dependent-care option to preference for other attractive benefit options.

ETS estimates the cost of dependent care to be $250 per month per employee. In 1984, approximately $31,000 was contributed by ETS to its employees' dependent-care costs.

In an effort to increase the supply of child care in the community, ETS made a two-year, start-up grant to a local infant-care center. ETS employees may apply their flexible credits to the purchase of these services and, in addition, receive a discount on their fees. Approximately 12 to 15 ETS employees have enrolled their infants in this program. ETS considers inclusion of dependent care in its flexible benefit plan to be its primary response to the child-care problem. Some changes are planned given the proposed IRS regulations—such as no more cash-outs and no vacation carryovers—but the dependent care option remains stable and secure.

The Flexible Spending Account and Salary Reduction

A flexible spending account (FSA) is a reservoir of funds upon which employees may draw to cover the costs of benefit options not included in the regular benefits package. Many employers create FSA's in order to avoid the complexity and administrative costs characteristic of broader cafeteria plans. An additional appeal of the FSA is that it can be funded through employee salary reduction—at no cost to the employer. The list of benefits to which funds from the FSA can be applied is identical to the optional benefits included in a cafeteria plan (page 21).

The Employer Council on Flexible Compensation estimates that between 300 and 500 companies have set up flexible spending accounts. When municipalities, nonprofit organizations, small retailers, and professional firms (accountants, lawyers and architects) are added, as many as 1,000 FSA's may be in existence at the time of this writing. With final regulations on Section 125 yet to be issued, and tax reform proposals pending, the future of FSA's is uncertain.

Funding FSA's

Many FSA's are funded with employer contributions. For example, Chemical Bank contributes $300 to each employee's account. Hewitt Associates puts in $360 to $1,560 per employee, depending on years of service. Another source of funding for the FSA is profit-sharing and savings accounts. Mellon Bank and Chemical Bank allow employees to allocate up to 50 percent of profit-sharing funds to the spending account.

Nearly all employers with FSA's, however, implement a program of salary reduction. Under the law, the amount of salary reduced is treated as employer-provided amounts. This enables an employee to use pre-tax dollars for needed benefits and services. In addition, the employer can add new benefits without incurring additional benefit costs. In fact, employers may save money because they do not pay social-security or federal unemployment-insurance taxes on the amount of salary reduced.

While the practice can be of significant financial assistance to employees, the term "salary reduction" is threatening. This has led to a variety of titles. Chemical Bank's program is called "Salary Redirection"; Pepsico's is a "Choice Pay Reserve Account"; and Toro Company's child-care financing is called a Dependent Care Expense Account.

The savings for employees can be considerable. If, for instance, an employee earns $50,000 and has $3,000 in child-care expenses, the employee can pay income taxes based on a $47,000 salary and spend the $3,000 needed for child care out of pre-tax dollars. Table 8 shows the tax savings to a married employee with an adjusted gross income of $50,000, and who elects a salary reduction of $3,000 to cover dependent-care expenses. (See also Appendix B.)

Many employers put a cap on the amount of salary that can be reduced. Employers choose to do this in an effort to meet the nondiscrimination tests defined by Sections 129 and 125 of the Internal Revenue Code. This ceiling is often set at $5,000 per employee. The total amount available for dependent care may be greater if employer dollars or a portion of profit-sharing accounts are contributed to the employee account. Some employers, such as Pepsico, have a $5,000 cap for reimbursed medical expenses and a separate cap for dependent care. Toro Company has a cap of $2,400 for health-care costs and $4,800 for child care. General Foods allows $1,800 to be spent on health care and $5,800 for dependent care. The separate accounts eliminate the possibility that an employee will have to make a choice between quality health care and quality child care.

Table 8: Expenses, Taxes and Salary Reduction: An Example

	Without Salary Reduction	*With Salary Reduction*
Salary	$50,000	$50,000
Salary Reduction		3,000
Income	50,000	47,000
Taxes		
Federal (Joint Return)	10,238	9,186
FICA (Employee's Share)	3,350	3,149
Total	13,588	12,335
After-tax Income	36,412	34,665
Dependent-care expenses	3,000	0
Dependent Care Tax Credit	600	0
Net Income After Expenses	34,012	34,665
Savings		653

These estimates are based on 1984 tax figures, assuming three personal exemptions and no deductions, additional income, adjustments to income or other tax credits.

The funds from the account are either included in the employee's regular paycheck or are made available as a separate payment on a bi-weekly, monthly or quarterly basis. The frequency of distribution to Pepsico employees varies depending on the amount to be reimbursed. At Toro Company, reimbursement differs for hourly workers and salaried office workers.

Utilization

The proportion of employees taking advantage of salary reduction for dependent care is relatively low. This cannot be explained with any consistency by the surveyed companies. The highest rate of use was reported by a thirty-eight-person law firm at which all five of the employees with dependent-care expenses made use of the firm's new policy. Among 154,000 employees at Pepsico, an estimated 6 percent pay for dependent care with pre-tax dollars. More than 300 of the 8,000 employees at The St. Paul Companies have their salaries redirected for dependent-care purposes. A much smaller proportion of Mellon Bank employees (2 percent of 6,800 employees) have taken advantage of dependent-care financing.

Hospitals, with a greater number of female employees, may find higher utilization of the dependent-care option. For instance, Good Samaritan Hospital and Medical Center in Portland, Oregon, figures that, for the period of January through June, 1984, 71 percent of the $457,000 deposited in employees' flexible spending accounts was allocated to dependent-care expenses.[10]

While all companies follow the guidelines of Section 129 that permit expenditures on care for children, elderly parents, or disabled dependents, none has differentiated the type of dependent-care purchased. However, in company interviews, managers felt that most reimbursements from flexible spending accounts were applied to child-care expenses.

Nor have companies collected information on the distribution of use among employee groups. Most companies indicated in interviews that use of dependent-care assistance was equally distributed across income groups, but that mothers took advantage of the benefit more often than fathers. Broad distribution among income groups is desirable in order for companies to meet the IRS-proposed nondiscrimination test (highly compensated employees cannot receive the greatest share of the benefits). The potential for discrimination is highest when salary reduction is the mechanism used for funding FSA's, because lower-income employees may fare better when taking advantage of the child-care tax credit. (See Appendix B.)

J.C. Penney and Morgan Guaranty Trust Company provide guidance to their employees in determining the degree to which the tax credit, salary reduction—or some combination of the two—would be most advantageous. The National Women's Law Center estimates that the adjusted gross income levels at and below which the dependent-care credit is at least as advantageous as salary reduction for dependent-care expenses are $26,000 (for married taxpayers filing jointly),

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[10] *EBPR Research Reports*, Charles D. Spencer & Associates, Inc, 222 West Adams Street, Chicago, IL 60606, pp. 13-14 (8-84).

$22,000 (for heads of household), and $19,200 (for single taxpayers) under 1984 tax rates. While the tax credit may yield more money for lower-income parents in the long run, some may prefer salary reduction because they can receive reimbursement as services are purchased, rather than at the end of the tax year.[11]

Recognizing the advantages of salary reduction for higher-wage earners, the imposition of a cap on the amount of salary that can be reduced may help reduce the likelihood of discrimination. For instance, a cap of $5,000 would prevent a $75,000-a-year employee from receiving $12,000 in tax-free dollars to pay for an in-home housekeeper.

Planning

Most of the employers responding to this study identified child-care needs through surveys of employees conducted while the FSA was in the planning stages. A spokesman for Toro Company explained: "In investigating the health-care expense account, we looked at other pre-tax alternatives and discovered dependent care." Only Chemical Bank and The St. Paul Companies, among the respondents, indicated that a range of child-care initiatives had been investigated prior to adoption of the FSA. In the smaller firms, the impetus for inclusion of dependent care emerged from the experience of a decision maker who had child-care expenses and understood the burden they impose.

Two Company Experiences

Flexible spending accounts have become popular with banks, although the design of their plans vary considerably. The following examples describe two bank experiences with spending accounts and dependent care.

Mellon Bank: In an employee survey conducted in 1980, Mellon Bank (Pittsburgh, Pennsylvania) learned that 48 percent of its employees believed that the Bank's benefits were not as good as those provided by its competitors. A comparative study of benefits confirmed the employees' perceptions. The primary reason for the dissatisfaction with Mellon's benefits was that they were heavily weighted toward retirement and profit sharing—benefits that are not as useful to their 60-percent female population as to the male work force. Management decided that flexible benefits and salary reduction might address this problem. On April 1, 1983, the salary redirection program was implemented for Mellon's 6,800 employees. In a 1984 survey of employees, it was found that 77 percent felt that the benefits provided by Mellon Bank were as good as—or better than—those provided by its competitors.

Chemical Bank in New York was unwilling to adopt the comprehensive cafeteria plan because of its administrative complexity. However, the Bank was concerned about the rising cost of benefits and the changing demographics of its work force. The investigation into alternative approaches in benefits delivery eventually led to the creation of an employee spending account and salary redirection program. As part of its 1981 review of benefits, Chemical Bank had a third party conduct interviews and a demographic study. Although Chemical Bank spent approximately $120 million on benefits in 1983, the investigation revealed that it was not meeting the needs of a majority of its employees. It was discovered that fewer than 13 percent of the Bank's 18,659 employees fit the traditional, male-breadwinner profile. Rather, 59 percent of Chemical Bank's employees are women, and this figure is expected to rise to 67 percent by 1987. Furthermore, 50 percent of the workers are single.

The following goals were established for the redesign of benefits to address the issues of cost and demography.

(1) Benefit costs should be comparable to those in other New York City banks.

(2) Benefit strategies should establish Chemical in a leadership position as an organization responsive to employee needs.

(3) The redesign plan should make employees feel more secure, for example, by rewarding longer service.

(4) The plan should be tax-effective and flexible for the company—taking into account the bank's shifting demographic, economic and legal environment.

(5) The plan should be simple enough for its value to be recognized.[12]

Chemical Bank's Employee Spending Account (ESA) appeared to satisfy these goals. The Bank deposits $300 into the ESA's, and employees eligible for profit sharing can add up to 50 percent of their annual profit-sharing payments to this sum. (In 1983, 64 percent of eligible participants contributed to ESA's.)

Under the Economic Recovery Tax Act, the overall reimbursement limit for employer contributions is $800 per year. This was the maximum amount that could be spent on all optional benefits until September, 1983, when the Salary Redirection Program was introduced. Under this program, employees could redirect up to $2,000 per year of their salaries to their pre-tax accounts. In 1984, a $5,000 limit was set on salary redirection. Including the employer contribution and profit-sharing diversion, employees can spend a maximum of $5,800 on the following benefits: dependent care, medical deductibles and co-insurance, dental insurance premiums, legal fees, and expenses for medical and dental services not covered by insurance. Employees are reimbursed from their accounts on a quarterly basis.

In 1983, there were 20,000 claims for reimbursement from ESA's. An estimated 1.3 percent of these claims were for dependent care. Approximately 6 percent of reimbursement dollars were for dependent care; 90 percent of the dependents needing care were children. These employees received $267,061

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[11] A complete explanation of calculations by the National Women's Law Center appears in Appendix B, and was specially prepared for this report by Sally Goldfarb.

[12] Donald C. Platten, "The Employee Benefits—Does the Company Also?" *Harvard Business Review*, September-October, 1983, p. 20-21. See also "Chemical Bank's 'Employee Spending Account'," *Benefits News Analysis*, February 1983, Vol. 5, No. 2, pp. 4-8.

An Assessment of Flexible Benefits and Inclusion of a Dependent Care Option

(Based on the experiences of identified companies)

General Advantages of Flexible Benefits Plans

- An equitable response to diversity.
- Control or reduction of benefit costs. Flexible benefits help break the pattern of "more," by establishing a limit on value of the total benefits package.
- Employee awareness of benefits and their cost. Employees must be educated about all benefits before making choices. They may come to appreciate the employer's benefit expenditures.
- Particularly useful when creating a unified package of benefits following a merger or acquisition because of the need to blend two different benefit packages.

Specific Advantages for a Child Care Option

- Reduces inequities of responding to the needs of parents by satisfying other employees' needs.
- Low cost, since the cost of child care can be shared by the employee.
- Offers flexibility so that the program can adapt to fluctuations in employee needs.

Disadvantages of Flexible Benefits Plans

Potentially high implementation costs are incurred as communication and computerization needs are met.

- Adverse selection—the probability that employees with a greater chance of incurring the risk may select the option, while those with a lesser chance will choose other benefits. Since group insurance rates are based on an even distribution of risk, the costs of insured programs in a cafeteria plan may fluctuate because the covered group will represent the poor risks. Insurance companies estimate that adverse selection might account for a 3-5 percent increase in benefit costs.
- Tax law uncertainties due to the lack of final regulations on IRC Section 125 and impending debates on tax reform.

Specific Disadvantages for a Child Care Option

- The child-care option may not be sufficient if there is inadequate child care to be purchased in the community.
- May force parents to choose between needed health-care and child-care benefits.
- Lower-paid employees may benefit more from the Dependent Care Tax Credit.
- Possible discrimination if the demographics of the work force are such that parents are disproportionately found among upper-income employees. The plan would be invalid if the company cannot meet the nondiscrimination test.

in pre-tax dollars to spend on dependent care. In 1984, dependent care accounted for nearly 2 percent of all claims and 8.7 percent of reimbursement dollars. Employees received $584,053 in dependent care assistance.

Chemical Bank's interest in finding a solution to child-care problems surfaced before the implementation of the spending account. Employee inquiries and responses to attitude surveys sparked some interest; media influence and suggestions from women's organizations heightened the pressure. An on-site center was considered, but there was concern about equity and location—Chemical has local branches and offices at 270 locations in the New York State area alone. Adoption of Section 129 of the Internal Revenue Code prompted management to include child care in a reimbursement program.

There are no plans for future child-care initiatives. One reason cited by management for the lack of an additional response was that few employees speak up about their child-care problems—particularly professional women who are in management positions. The Bank is investigating its options with regard to compliance with proposed IRS regulations.

Changes Proposed by the IRS

In early 1984, an accountant in Milwaukee had his taxes audited and questions were raised about the taxability of services purchased through his employer's zero-balance reimbursement account—or ZEBRA. Under a ZEBRA plan, employees could be reimbursed for reported child-care expenses, for instance, while their paychecks were reduced by the amount paid as reimbursement. The employee did not pay taxes on that part of the salary used for child care.

The IRS challenged ZEBRA plans, as well as other forms of flexible compensation, in its Information Release (IR 84-22) of February 10, 1984, which stated that such arrangements are "without substance and do not reduce employees' taxable income." The IRS had waited five years to propose regulations to Section 125 while refusing hundreds of individual requests from companies to review their plans and issue a private-letter ruling that would approve the plans. Further, the IRS now proposed retroactive tax penalties on employees and employers. Ambiguity in the release further worried companies and advocates of such plans, because it looked as though all forms of flexible spending accounts—and not just ZEBRA's—were illegal. A spokesperson for The Wyatt Company, a benefits consulting firm, was quoted as saying:

> "The IRS position would retroactively penalize hundreds of companies and millions of employees who have acted in good faith, destroy a major private-sector initiative to involve employees in health-care cost containment, effectively eliminate company-provided child-care benefits for working mothers, and have a chilling effect on legitimate cafeteria benefit plans that promote employee choice."[13]

On May 7, 1984, the IRS published proposed regulations clarifying and modifying some of the positions made in its February statement. Dissatisfied with that proposal, the business community pressured Congress to respond to the IRS ruling. Legislative proposals made by Representative Barber Conable and Senator Robert Packwood were not voted on, but a provision in the Deficit Reduction Act of 1984 allowed flexible spending accounts in existence or being implemented on February 10, 1984 to continue, and provided for relief from retroactive tax penalties until January 1, 1985. Special relief is provided through July 1, 1985 for certain provisions of the proposed regulations. To qualify for this extended grace period, plans must require employees to determine their contribution amount before the plan year starts and no cashout of unused funds is available before the end of the grace period, plan year.

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[13] "IRS Upsets Practitioners with Flexible Benefits Announcement," *Daily Report for Executives*. Washington, DC: Bureau of National Affairs, February 23, 1984, p. K-4.

The IRS held hearings on its proposed regulations on July 26, 1984, that were followed by a more general discussion of the taxability of benefits in hearings before the Senate Finance Committee. The date for issuance of final regulations by the IRS is uncertain, but companies with flexible plans are to comply with the provisions outlined in the proposed rules made in May and the Transitional Rules proposed on December 31, 1984.

While elements of the proposed rules remain controversial, the structure of flexible plans has been defined. It is clear, for instance, that "ZEBRA plans are dead," as one consultant proclaimed. Salary reduction plans are permitted and the proposed regulations require that employees make an irrevocable selection of benefits, once a year, and amounts be elected *before* expenses are incurred by the employee. Benefit elections may be revoked during the year due to a change in status such as marriage, divorce, death of a spouse or child, birth or adoption of a child, and termination of employment.

It has been recommended by some that in order to anticipate child-care expenses properly, other allowable changes in status should include a move from part-time to full-time work, family illness, and a change of child-care providers. To illustrate: If a parent switches from a family day-care home to a day-care center, costs might double. The unanticipated extra costs cannot now be covered under the flexible benefit plan.

Another requirement of the proposed regulations is the forfeiture of unused funds. After the grace period for pre-existing plans which ends June 30, 1985, if the employee does not use all funds set aside at the beginning of the plan year for dependent care, or any other benefit, then the employee loses them. Prior to this requirement, most employers provided unused funds as taxable cash or allow employees to carry them over into the next year's account. The primary purpose of the forfeiture provision is to preserve "risk sharing," a cornerstone of tax treatment for group insurance benefits. The IRS further intended to limit the amount of money put into spending accounts—since they ultimately lead to a reduction in revenues for the federal treasury.

The effects of the forfeiture provision may be significant. The majority of employers have instituted flexible spending accounts primarily for the purpose of controlling health-care costs. Employees using flexible spending accounts had a built-in incentive to spend medical dollars wisely because unused funds were refunded. However, because medical expenses are not predictable, an employee might discover at year's end that only $2,000 of the $3,000 set aside for health care has been spent. As one benefits specialist surmised: "Such people might run to the nearest health spa to use the rest of the allocation." The forfeiture provision thus renders FSA's ineffective in controlling health-care costs because they are unpredictable. On the other hand, employees may deliberately underestimate health expenditures—especially workers earning low salaries, who are least able to risk forfeiture. This group of employees will choose taxable cash instead of benefits, and will be unable to reap the intended advantages of using pre-tax dollars to acquire needed services.

Most benefit planners believe that the "use-it-or-lose-it" feature now required in flexible spending accounts will curtail their use for medical-care expenses. Furthermore, some companies may hesitate to implement flexible accounts because of their potentially negative impact on employee relations when unused funds revert to the employer. Dependent care, as a more predictable expense than health care, may become the sole benefit offered through flexible accounts. But, one benefits expert predicts, its growth will be inhibited because "it will no longer be dragged along by the proliferation of medical reimbursement accounts."

Another regulatory issue that may negatively affect the growth of dependent-care assistance provided through flexible spending accounts is the nondiscrimination test. It may be that the test will cover both the availability of benefits and their use. As proposed, a Section 125 plan must not discriminate in favor of highly compensated employees (with "highly compensated" defined as someone who is an officer, or a shareholder owning more than 5 percent of the voting power or value of the stock). A plan is also considered discriminatory if key employees receive over 25 percent of the aggregate value of nontaxable benefits provided to all employees (with "key employees" defined as officers of the company earning more than $45,000 a year). In addition, the nondiscrimination test requirements of Section 129 must be satisfied, although provisions seem to complement those required by Section 125. According to benefit consultants, it is likely that the nondiscrimination test will be similar to the test applied to pension planning where the top one-third of earners receive amounts in proportion to the bottom two-thirds of earners. If, for instance, the average compensation of the lower two-thirds of employees is $20,000 and there is a $1,000 limit on the amount that salary can be reduced, then the top-earning one-third, whose average compensation is $40,000, may be limited to $2,000 of salary reduction—both groups receiving 5 percent of salary in pre-tax dollars.

The nondiscrimination test, if based on utilization, raises some problems for inclusion of dependent care in some work forces. Younger, lower-paid workers may be less likely to have children or elderly parents than somewhat older, more highly paid workers. Furthermore, lower-paid workers may gain more from the dependent-care tax credit than from salary reduction. (See Appendix B). While the employer has made the benefit plan available to all employees, it may find that only the highly-compensated use it. If the nondiscrimination test is based on utilization, some plans may not satisfy it.[14]

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[14] Comments submitted by the National Women's Law Center to the Commission of Internal Revenue on Tax Treatment of Cafeteria Plans, July 6, 1984.

Table 9: Features of Flexible Spending Accounts (FSA)

	Chemical Bank	*Pepsico*	*Mellon Bank*	*Toro Company*	*St. Paul Companies*	*Slade and Pellman*
Name of Program	Salary Redirection	Choice Pay Reserve Account	Salary Redirection	Health Care Expense Account; Dependent Care Expense Account	Reserve Account	Dependent Care Assistance Plan
Benefit Choices	DCAP, medical, dental, HMO premium, legal, accident premium	DCAP, medical, dental, vision/hearing	DCAP, medical, dental, vision/hearing	DCAP, medical, dental, vision/hearing	DCAP, medical, dental, vision/hearing, legal	DCAP
Method of Funding Account	Salary reduction, employer contribution ($300), profit sharing	Salary reduction, trade-off with other benefits	Salary reduction, employer contribution, profit sharing	Salary reduction	Salary reduction	Salary reduction
Limit on Salary Reduction	$5,800	$5,000—DCAP $5,000—unreimbursed health	$6,000—DCAP $1,800—unreimbursed health	$4,800—DCAP $2,400—medical/dental	$3,500	N.A.
Method of Distribution	In paycheck quarterly	Separate payment Monthly if $200; Quarterly if $200	Separate payment Monthly as requested	In paycheck on regular paydays for hourly workers; monthly payment to salaried office workers	Separate payment biweekly	In paycheck on regular paydays
Utilization of DCAP	8.77%[1]	6%	2%	N.A.	4%	15%
Number of Employees	N.A.	154,000	6,800	2,200	8,000	38

[1] Chemical Bank's estimate for the utilization of dependent-care benefits is based on the percent of claims. All other company estimates are based on the percent of employees who claim the credit.

N.A. = no answer

To prevent the disproportionate use of benefits by "highly compensated" employees, some have suggested that a cap be imposed on the amount reimbursed under a flexible plan. Many benefit-consulting firms recommend a cap of $5,000 to assure nondiscrimination in the plans. Both Representative Conable and Senator Packwood included caps—a separate one for dependent care—in their proposed legislation. The Conable bill suggested that a cap be integrated with the Dependent Care Tax Credit. If, for example, an employee claimed $2,400 in dependent-care expenses under salary reduction, under the Conable bill, that person could not claim any expenses toward the tax credit, since $2,400 is the maximum limit on the credit for one dependent. Senator Packwood proposed a higher cap of $3,000 for dependent care. The IRS has not proposed any cap.

At the time these data were being gathered and analyzed, the range of tax-simplification and tax-reform proposals was not yet evident. It was, however, becoming apparent that interest in these issues was emerging. Not unexpectedly, proponents of financial assistance for child care through tax credits and nontaxable benefits felt that these approaches (singly or in combination) merited continuation. To them, the need for affordable child care is apparent, given the changing work force and the inadequate supply of care.

Other Financing Alternatives

The child-care assistance programs selected for detailed study were those that focused primarily on the affordability of child care for employees. Several corporations have developed other ways to help working parents pay for child care, but these efforts may be part of another initiative, such as the funding of an on-site day-care center; others may provide financial assistance to the community-at-large through corporate contributions. In addition, employee groups and unions have the opportunity to create a fund—called the Voluntary Employee Beneficiary Association (VEBA)—through which employees can be helped to cover child-care expenses. Some employers focus their efforts on lobbying the Federal Government to help improve the child-care system and expand the child-care tax credit. These alternatives are described briefly below.

Subsidizing On-Site Day Care

According to the Work and Family Information Center, approximately 120 corporations and 400 hospitals currently sponsor day-care centers on or near the workplace. Nearly all of these employers provide the necessary start-up costs and most offer in-kind contributions that may lower the fees to the parents. Some of these employers also subsidize fees at the centers. According to a 1982 study conducted by the federally funded National Employer Supported Child Care Project, 84 employers offer a subsidy to help employees pay tuition fees in 211 on-site day-care centers. Fee assistance may assure greater utilization and prevent the center from becoming a discriminatory benefit. When fees are set at prevailing market rates, low-income employees may be prevented from using the on-site program. At Intermedics in Freeport, Texas, employees using the 289-child center pay only 40 percent of the cost of the $1-million budget of the center.

Campbell Soup Company, with a center run by Kinder-Care, subsidizes approximately 50 percent of its employees' cost of care. Hospitals, desperate for night-shift nurses, may make on-site centers available free of charge only to this group of employees. The costs of starting and subsidizing an on-site center may be high when the per employee cost of the benefit is considered. The level of financing commitment will depend on the nature of the child-care problems facing employees, and the company's motive for funding the center.

Corporate Contributions

An employer who approaches the child-care issue as a matter of corporate social responsibility may provide a financing solution that is not limited to its own employees. For example, since 1981, John Hancock Mutual Life Insurance Company in Boston has been making an annual donation of $50,000 earmarked for child care to the United Way of Massachusetts Bay. In addition, John Hancock has been donating $25,000 to two nonprofit day-care centers located near the company's headquarters. This money has been used to subsidize scholarships for children of low-income families in the community.

The Corporate Child Development Fund for Texas provides a convenient mechanism for employers to channel corporate contributions into child-care programs in communities in which the companies have plant sites. The Fund has received grants ranging from $500 to $10,000 from more than 40 corporations. Money is raised from urban-based employers and the Fund then makes grants to child-care programs in rural communities where there are not many large employers. While the employees of contributing companies are not guaranteed enrollment in these rural programs, they are encouraged to take advantage of the opportunities provided by these grants.

Voluntary Employees' Beneficiary Association (VEBA)

The purpose of the VEBA [organized pursuant to Internal Revenue Code Section 501(C) (9)] is to provide for the payment of life, sickness and accident insurance or other benefits to employees and their dependents.

VEBA's may be used to offer grants to child-care centers where employees' children are served and where employees have financial responsibility for the child-care program. The number of nonemployees who may be served by the child-care facility may not exceed 10 percent of the total enrollment in the program. The Hyman Blumberg Child Day Care Center, sponsored by the Amalgamated Clothing and Textile Workers Union, was organized through a VEBA in 1968.

Lobbying

Lobbying Congress for increased child-care support requires a commitment of time and political clout, rather than of cash. Due to cutbacks in welfare programs, a number of low-income employees became ineligible for federal subsidies for child care provided under Titles XX and IV-A of the Social Security Act. Companies might have used their influence to protect child-care subsidies, had they been aware that some of their own employees would be affected by these cuts in service. The Child Care Tax Credit also helps working parents, but some feel that the credit should be based on more realistic child-care costs. Some employers have supported an expansion of the credit, currently limited to $2,400 for one child.

Many companies spend a considerable amount of time investigating their child-care options. They become intimately familiar with the child-care needs of their employees and the capacity of community services to meet them. With this knowledge, employers are testifying before Congress and participating on mayoral and gubernatorial task forces on child care. In this way, the views of the business community are considered in the redesign of the delivery system and attempts to improve the affordability and quality of child-care programs.

Part 3

Summary

Among the estimated 1,800 employers nationwide responding to child-care needs, the predominant response is the provision of some form of financial assistance. Among the financing options, flexible benefits is emerging as the most popular financing option.

A company's desire to provide meaningful financial assistance to the employee may result in considerable expense to the employer. At a time when companies want to control benefit costs, and also to improve their benefits packages to satisfy a new diversity in the work force, financial assistance for child care is most frequently embodied in a flexible benefit plan that includes a variety of benefit options. The vast majority of flexible plans offer bank accounts and salary reduction without total benefits revision. The need for child-care assistance has emerged during the planning of a flexible plan when employees have been asked to identify desired benefits.

The companies pursuing alternative approaches, such as vouchers and discounts, have a different orientation and commitment to solving child-care problems. Most of these companies conducted surveys of child-care needs among employees and examined the full range of child-care solutions before settling on financing options.

The vouchers represent the greatest financial commitment to child care of all the options, sometimes requiring a generous investment of corporate dollars. Vouchers are also the least popular option among companies in this survey. Discounts are also selected after an analysis of all child-care solutions, but they are less costly to the employer, may be less valuable (in dollar terms) to the employee, and more limited in their use because they may only be used at specific day-care centers.

The Future of Child Care Financing by Employers

The number of working parents with child-care needs is unlikely to decrease in the near future. Affordability may become the most pressing child-care problem as the cost of providing quality care increases and as employees seek care from credentialed programs to reduce worry about sexual abuse. As an alternative to starting their own child-care centers, some employers will concentrate on helping their employees pay for child-care already provided in the community. In this way, they can allow employees to choose their own arrangements and, as a result, serve a greater number of working parents with a variety of child-care needs. Among the range of child-care solutions, financial assistance—in its varied forms—may grow most rapidly.

Appendix A

Sample Dependent Care Assistance Plan[1]

This is a sample plan. Employers should consult their own tax attorneys or advisors with respect to adoption and implementation of any Dependent Care Assistance Program. If dependent care is to be offered as part of a flexible benefits program, then the requirements of Code section 125 must also be satisfied. The provisions of this sample 129 plan can be incorporated into a 125 plan which should be submitted to the Department of Labor.

ABC CORPORATION
DEPENDENT CARE ASSISTANCE PLAN*

1. *Purpose.* The company wishes to assist its employees in the care of their qualified dependents and therefore has adopted the ABC Corporation Dependent Care Assistance Plan (the "plan") set out herein for the exclusive benefit of those employees who are eligible to participate in the plan. The plan is intended to qualify as a dependent care assistance program under section 129 of the Internal Revenue Code of 1954, as amended and shall be construed to comply with Code section 129.

2. *Definitions.* The following terms are defined for purposes of the plan and are indicated by capitalized initial letters wherever they appear in the plan:

a. "Dependent" shall mean (i) any child of an employee who is under age 15 or who is physically or mentally incapable of caring for himself or herself and with respect to whom the employee is entitled to claim an exemption for federal income tax purposes or who is in the custody of the employee for at least six months during the calendar year; and (ii) a spouse of the employee who is physically or mentally incapable of caring for himself or herself.

b. "Employee" shall mean any person employed by the company any portion of whose income is subject to withholding of income tax and/or for whom social-security contributions are made by the company, as well as any other person qualifying as a common law employee of the company.

c. "Dependent Care Expenses" shall mean amounts paid for the care of a dependent in the employee's home or at a dependent care facility which meets all applicable requirements of state or local law or is exempt from such requirements under the state or local law in question and amounts paid for related household services, except that the following items shall not be considered dependent care expenses:

(i) Amounts paid to a person with respect to whom the employee or his or her spouse is entitled to claim an exemption for Federal income tax purposes;

(ii) Amounts paid to a child of the employee who is 18 years of age or younger; and

(iii) Amounts paid for or reimbursed under another plan of the company or to which the company contributed on behalf of the employee, under any Federal, state or local program of dependent care assistance, or by an employer of the spouse or by an educational institution where the spouse is an enrolled student.

3. *Effective Date.* The plan shall be effective on ________________.

4. *Eligible Employees.* All employees of the company shall be eligible to participate in the plan.

5. *Reimbursement of Expenses for Dependent Care.*

a. Upon application of the employee, accompanied by a bill, receipt, cancelled check, or other written evidence of payment or of the obligation to pay dependent care expenses, the company will reimburse the employee for dependent care expenses incurred in order to enable the employee to be employed by the company, subject to the limits of paragraph b. The company reserves the right to verify all claimed expenses prior to reimbursement.

b. *Limitation on Benefits.* The maximum amount of dependent care expenses which will be reimbursed under this plan shall be the lowest of:

(i) $__________ per calendar year; or

(ii) If the employee is single or is married and earns less than his or her spouse in a calendar year, the compensation paid to the employee by the company as reflected on his or her Form W-2 for the year; or

---

[1] Prepared by Barbara B. Creed, Partner, Pillsbury, Madison and Sutro, San Francisco, CA and Deene Goodlaw Solomon, Counsel, Pillsbury, Madison and Sutro. Reprinted with permission from the Child Care Law Center, San Francisco, CA.

* Additional plan provisions will apply and other considerations will pertain if the plan is an "employee welfare benefit plan" as defined in section 3 (3) of the Employee Retirement Income Security Act of 1974, as amended.

(iii) If the employee is married and the earned income of his or her spouse is less than the compensation paid to the employee by the company in a calendar year, the earned income of the spouse. If the spouse is a student or is physically or mentally incapable of caring for himself or herself, the spouse will be deemed to have earned income (for each month that the spouse is a student or incapacitated) of $200 per month if the employee has one dependent for whom care is provided and of $400 per month if the employee has two or more dependents for whom care is provided.

The company may require that the employee and/or his or her spouse certify to the company the amount of such spouse's expected earned income for the calendar year in question and may require that the employee provide documentary evidence of the amount certified in the form of an employment contract, paycheck stub, medical records (if the spouse is incapacitated) or a school enrollment form (if the spouse is a student).

c. *Direct Payment in Lieu of Reimbursement.* The company may, in its discretion, pay any expenses for dependent-care directly to the dependent-care provider in lieu of reimbursing the employee in satisfaction of its obligations under the plan.

d. *Limitation of Benefits Paid to Prohibited Group.* No more than 25% of the benefits paid under the plan in any one calendar year shall be provided for the class of individuals (or their spouses or dependents) each of whom owns more than 5% of the stock of the company, determined in accordance with Code sections 1563(d) and (e) without regard to Code section 1563(e) (3) (C), on any one day of that calendar year. If the benefits payable under the plan to such class exceeds the limits of this paragraph, the benefits paid to each individual member of the class shall be reduced proportionately.

6. *Funding Method.* The benefits provided under the plan are funded entirely out of the general assets of the company.

7. *Notification of Terms of Plan.* A copy of the plan shall be given to all employees.

8. *Statement of Benefits.* On or before January 31 of each year, the company shall furnish each employee who received benefits under the plan a written statement showing the amounts paid or the expenses incurred by the employer in providing dependent-care assistance under the plan for the prior calendar year.

9. *Amendment or Termination.* The company may amend or terminate the plan at any time; provided, however, that any such amendment or termination shall not affect any right to benefits arising prior to such amendment or termination or shall cause benefits paid hereunder not to qualify as dependent-care assistance under Code section 129.

10. *Governing Law.* This plan and the rights of all persons under the plan shall be construed in accordance with and under applicable provisions of the Internal Revenue Code of 1954, as amended, ERISA and the laws of the State of California.

[Note: The following provisions should be added if the plan is an "employee benefit plan"]

11. *Fiduciary Responsibility and Plan Administration.*

a. *Plan Sponsor and Plan Administrator.* The "plan sponsor" and the "administrator" of the plan, within the meaning of the Employee Retirement Income Security Act of 1974 ("ERISA"), is the company.

b. *Named Fiduciary.* The company is the named fiduciary responsible for the operation and administration of the plan.

c. *Assignment of Duties.* The duties of the company hereunder shall be carried out in its name by its executive committee, officers and employees. The company may designate any person to carry out fiduciary responsibilities under the plan pursuant to a written instrument which specifies the fiduciary responsibilities assigned to each such person. Any person may serve in more than one fiduciary capacity with respect to the plan.

d. *Employment of Advisors.* The company or a fiduciary designated by the company, may employ one or more persons to render advice with regard to its fiduciary responsibilities under the plan.

12. *General Plan Information.*

a. *Employer Identification Number.* The Employer Identification Number assigned to the company by the IRS is: ____________________.

b. *Plan Number.* The Plan Number assigned to the plan by the company is: ______________.

c. *Plan's Fiscal Year.* The date of the end of the year for purposes of maintaining the plan's fiscal records is: ____________________.

d. *Agent for Service of Legal Process.* The agent for service of process with respect to the plan is: ____________________

____

TO RECORD THE ADOPTION OF THE PLAN, the company has caused this document to be executed by its duly authorized officer this ________ day of ______________.

ABC CORPORATION

By ______________________________

Its

Appendix B

Selecting a Tax Treatment Plan for Dependent Care: A Comparison Between Salary Reduction and the Dependent Care Credit*

by Sally F. Goldfarb, National Women's Law Center**

As more and more firms opt for flexible benefit plans, an increasing number of employees will face the choice between salary reduction and the dependent care credit as a means of gaining federal income tax savings for dependent care expenses. A taxpayer can use only one of these two tax treatment methods for any given dollar of dependent care expenses.

Although tax laws are continuously subject to change, it is useful to compare the current advantages of these two tax treatments for employees at various income levels.

The Rough Test

As a general rule, if an employee's marginal tax rate is lower than the percentage of dependent care costs that can be subtracted from the employee's tax liability by using the dependent care credit, then the employee will receive greater federal income tax savings by using the credit method.[1] (This comparison does not take into account Social Security tax savings available through salary reduction, because it could be misleading to do so without considering future Social Security benefits, which are subject to numerous variables beyond the scope of this article.) Of course, this rough test assumes that the employee's dependent care payments are equally eligible for the dependent care credit and for the employer's salary reduction plan. It also assumes that if dependent care benefits available under the salary reduction plan are not used, the employee will receive an equivalent amount of cash.

In order to apply this rough test, it is necessary to know the employee's adjusted gross income (which will determine what percentage of care expenses will be available as a credit) and the employee's taxable income (which will determine the marginal tax rate).[2]

To perform this comparison, the taxpayer should first locate the appropriate adjusted gross income on the Dependent Care Tax Credit chart (see page 8) to determine the percentage of care expenses that will be available through the credit. Then, the taxable income should be located on the applicable tax rate schedule in order to determine the marginal tax rate.[3]

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[1] "Marginal tax rate" refers to the rate (that is, the percentage) of tax levied on the last dollar of an employee's taxable income.

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** Attorney Sally F. Goldfarb prepared this article while a Women's Law and Public Policy Fellow at the National Women's Law Center. The author wishes to thank Nancy Duff Campbell, managing attorney of the National Women's Law Center, for her invaluable assistance. This article was made possible in part by funds granted by the Muskiwinni Foundation and the Charles H. Revson Foundation. However, the statements made and views expressed are solely those of the author.

[2] *Adjusted gross income* is total income minus moving expenses, employee business expenses, IRA and Keogh deductions, penalties on early savings withdrawals, alimony paid, and the deduction for a married couple when both work. *Taxable income* is adjusted gross income minus itemized deductions, personal exemptions, and a partial deduction for charitable contributions if one does not itemize deductions.

[3] The annual tax rate schedules are provided by the Internal Revenue Service. Although the tax rate schedules are not actually used by all taxpayers for calculating tax liability (for instance, most taxpayers with taxable income under $50,000 must use the tax tables rather than the tax rate schedules), the tax rate schedules are nevertheless ideal for determining marginal tax rates because the percentage at which each dollar is taxed is stated explicitly. All tax rate figures in this article are for the 1984 tax year.

Case Example

For a more specific example of how to apply the rough test, consider the following case. Assume that a head of household has an adjusted gross income of $25,000. The taxable income, computed by subtracting various deductions and personal exemptions, is $20,000. The appropriate charts indicate that the taxpayer is entitled to a tax credit of 22% of dependent care expenses and that the marginal tax rate at this level of taxable income is 24%. Based on this rough test, the taxpayer would conclude that the salary reduction method is more beneficial than the tax credit.

Employers can provide helpful guidance to their employees by pinpointing the precise income levels at which the dependent care tax credit is generally preferable to salary reduction and vice versa. Such determinations are crucial to the effective use of flexible benefit plans.

In order to make these determinations, certain basic relationships must be kept in mind. It is important to remember that the percentage of the dependent care credit declines (or stays the same) as income increases. By contrast, marginal tax rates rise (or remain stable) with increasing income. Also, a personal exemption is available for taxpayers and their spouses. Thus, married couples gain at least $2,000 in personal exemptions, and single taxpayers and heads of households gain at least $1,000. These exemptions are, of course, subtracted from adjusted gross income when computing taxable income.

Using these basic relationships, it is possible to calculate, first, the adjusted gross income levels at and below which salary reduction for dependent care expenses is never preferable to the dependent care credit method. Consider a married couple filing jointly with an adjusted gross income of $26,000. With two personal exemptions, the adjusted gross income is reduced to a taxable income of *at most* $24,000. (The actual taxable income may be lower because of deductions or additional exemptions.)

At an adjusted gross income of $26,000, the dependent care credit is worth 22% of the care expenses incurred. This percentage will *increase* as the adjusted gross income decreases. At the same time, at a taxable income of $24,000, married couples with joint returns have a marginal tax rate of 22%, and that marginal tax rate will *decrease* as taxable income decreases. Therefore, at an adjusted gross income of $26,000 or less, married couples filing jointly will find the dependent care credit equally or more advantageous than a salary reduction scheme.

In the same fashion, heads of households will find the dependent care credit at least as advantageous as salary reduction at adjusted gross income levels of $22,000 or less. Similarly, single taxpayers with adjusted gross incomes of $19,200 or less will find the dependent care credit to be the more advantageous tax treatment method.

The adjusted gross income cutoff points identified above do *not* mark the points at which salary reduction necessarily becomes more advantageous than the dependent care credit. For instance, a married couple with an adjusted gross income of $26,001 may or may not have a marginal tax rate that is higher than their 21% dependent care credit, depending on their number of deductions and personal exemptions.

The above cutoff points have all been based on adjusted gross income. However, taxable income, not adjusted gross income, is the key to determining the points at which *salary reduction* becomes the more advantageous tax treatment.

The taxable income levels at and above which salary reduction is always initially preferable to the dependent care credit are as follows: for married couples filing jointly, $24,002 in taxable income; for single taxpayers, $18,202 in taxable income; and for heads of households, $21,002 in taxable income.

Refining the Test

Employers and employees should add two important refinements to the rough test previously described, in order to be sure that their conclusions are accurate for individual cases.

The first refinement involves the total amount of dependent care expenses incurred for the year in question. As an example, assume that for the tax year 1984, a single taxpayer with one child and two personal exemptions, but no deductions, has an adjusted gross income of $21,000. Deducting the two $1,000 personal exemptions, this taxpayer has a taxable income of $19,000. Using the rough test previously cited, the taxpayer would note that the 26% marginal tax rate for taxable income of $19,000 is higher than the 24% dependent care credit available for an adjusted gross income of $21,000. Thus, the taxpayer would conclude that using the employer's salary reduction plan for dependent care expenses was the better method. But there could be a hitch. Suppose that the taxpayer's dependent care expenses were more than $800 for the year. In that case, the taxpayer would be better off allocating the amount exceeding $800 to the dependent care credit. This is because once the taxpayer reduces his or her income by $800 through salary reduction, the taxable income level falls to $18,200 (at that level, a 23% marginal tax rate applies). The adjusted gross income becomes $20,200 (entitling the taxpayer to a 24% dependent care credit). At that point, the relative advantages of the two tax treatments have become reversed. (Such a "tipping point" does not occur, however, in instances in which the rough test shows that the dependent care credit is more advantageous than salary reduction and the credit is accordingly used first. This is because the credit is subtracted from tax liability and does not alter either the taxable income or the adjusted gross income.)

The second refinement to the rough test requires knowing the maximum permitted dollar amount of dependent care expenses under the salary reduction plan, and the maximum permitted dollar amount of expenses that may be claimed for the dependent care credit. These maximum permitted amounts may be established in several ways. Employers may set a fixed maximum for salary reduction generally, or for salary reduction, dependent care benefits specifically. The statutory ceiling for expenses which may be counted toward the dependent care credit is $2,400 for one dependent and $4,800 for two or more dependents. Also, neither salary reduction for dependent care, nor expenses claimed for the dependent care credit, may exceed a taxpayer's or taxpayer's spouse's earnings, whichever is less.

If employees' dependent care expenses exceed the ceiling for their salary reduction plan or the credit—but not both—they should determine which of the two is more advantageous and then allocate their expenses to that option up to the maximum limit (unless they first reach a "tipping point," as discussed above). They should then allocate the remainder of their expenses to the other tax treatment. Of course, if employees' dependent care expenses equal or exceed the *sum* of the ceiling amount for the credit *and* the ceiling amount for their salary reduction plan, then they need not even determine which of the two is preferable; they should simply use each up to its applicable limit. Thus, for example, a taxpayer with $8,000 in dependent care costs who is eligible to claim $2,400 in expenses toward the dependent care credit and $5,000 in expenses through a salary reduction plan should use both of these methods fully—and will still have expenses "left over."

Necessary Information

As the above discussion indicates, employers or individual taxpayers wishing to use this refined test as effectively as possible need to have certain basic information available: yearly adjusted gross income, yearly taxable income, annual dependent care expenses, and the applicable ceilings on the dependent care credit and the salary reduction plan. They also must have access to the appropriate tax rate schedules and the dependent care tax credit chart. Ideally, all of this information should be obtained prior to the decision to elect dependent care benefits under a salary reduction plan for a given year. In fact, however, most taxpayers will have to make approximate projections of income and expenses and apply the refined test to these estimated figures.

One Method of Individual Tax Planning

While tax treatment decisions, are subject to continuous changes in the law, and must be fully evaluated by accredited professionals for each individual case, the author of this article believes that the following method of tax planning ensures optimal use of the dependent care credit and salary reduction for dependent care expenses.

This method involves eight principal steps. (All income figures are for 1984.)

1. For the year in question, first determine the amount of dependent care expenses that qualify for the dependent care tax credit and salary reduction. Then determine the ceiling on eligible expenses under the dependent care tax credit and under the salary reduction plan.
2. If dependent care expenses equal or exceed the sum of both ceilings, go no further. Use both tax treatments to the permitted maximum.
3. For the year in question, determine the adjusted gross income and taxable income.
4. If the adjusted gross income is less than or equal to $26,000 for married couples filing jointly, or $22,000 for heads of households, or $19,200 for single taxpayers, then proceed directly to step 7.
5. If taxable income is greater than or equal to $24,202 for married couples filing jointly, or $21,002 for heads of households, or $18,202 for single taxpayers, then proceed to step 8.
6. Determine the credit percentage by locating the adjusted gross income on the dependent care tax credit percentage chart. Find the marginal tax rate by locating the taxable income on the applicable tax rate schedules. Compare these two amounts. If the credit percentage is greater than or equal to the marginal tax rate, proceed to step 7. If the marginal tax rate is greater than the credit percentage rate, proceed to step 8.
7. Use the dependent care tax credit up to the applicable ceiling. Allocate remaining expenses to salary reduction. (It may be advisable to underestimate expenses for salary reduction in order to avoid the risk of forfeiting unused amounts at the end of the plan year.)
8. Determine whether there is a "tipping point". This is a level at which some portion of dependent care expenses, when subtracted from income through a salary reduction plan, reduces the taxpayer's taxable income to a point where the marginal tax rate is lower than the credit percentage available at the newly reduced adjusted gross income. If such a "tipping point" exists, allocate expenses to the salary reduction plan up to that point. Then allocate the remainder to the dependent care credit up to the applicable ceiling. If expenses still remain, allocate the remainder once again to the salary reduction plan. If there is not a "tipping point", allocate expenses to salary reduction up to the permitted ceiling and then allocate the remainder to the dependent care credit. (As noted in step 7 above, it may be advisable to underestimate expenses for salary reduction.)

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No. 181

The 1985-1986 U.S. Regional Outlook

Growing Signs of Uncertainty— Yet The Mood Is Generally Positive

By Lora S. Collins

Management Summary

New England 6

The New England economy is in a quite favorable situation. Unemployment is low, employment is increasing at a respectable pace, and per capita income is high.

"The Industrial Heartland" 8

The economic recovery that had begun to be felt in the Heartland faltered in the second half of 1984. With significant structural problems remaining, a bright future seems many years away.

Mid-Atlantic 9

The 1984 recovery was robust in the Mid-Atlantic, with all major economic indicators recording the best rates of improvement in well over a decade.

The Southeast 10

Really fast growth has been confined to Florida and Georgia, with the economic picture for the other states mixed.

"America's Breadbasket" 11

These are troubled times for the agricultural regions, and an improved farm economy is a number of years in the future.

The Southwest 13

Assuming continued national economic growth, the Southwest economy will continue to expand. However, growth will not be as strong as it was during the energy boom.

The Mountains 15

The diversified economies of the southern tier of states have done well despite the end of the energy boom, but the resourse-based northern states remain depressed.

The Pacific 17

The region should perform marginally better than the nation in the next few years, with high-tech industries a positive factor and timber, energy and agriculture negative ones.

ECONOMIC AND POLICY ANALYSIS PROGRAM

The Conference Board's Seventh Annual Regional Forum met in February 1985, gathering eight experts from around the country. The Forum's deliberations are summarized in this report.

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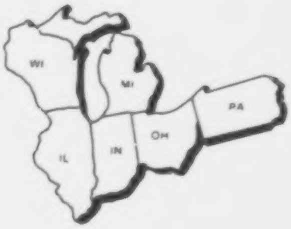
HIGHLIGHTS

The New England economy is in a quite favorable situation. Unemployment is low, employment is increasing at a respectable pace, and per capita income is high. Defense-related manufacturing, important in the region, promises to remain a steady source of job growth. Prospects for capital goods and exports, also regionally important, are clouded by the strength of the dollar. Also, the region may experience some labor shortages. However, New England should fare well in the next several years.

NEW ENGLAND

ME
VT
NH
MA
CT
RI

INDUSTRIAL HEARTLAND



The economic recovery that had begun to be felt in the Industrial Heartland faltered in the second half of 1984. This resulted in part from the national slowdown and in part from the region's orientation toward durable goods of the traditional type rather than toward the booming "high-tech" sector. Also, the strong dollar has dampened export markets for Heartland goods and boosted import competition. With significant structural problems remaining, a bright future for the Heartland seems many years away.

The 1984 recovery was robust in the Mid-Atlantic, with all major economic indicators recording the best rates of improvement in well over a decade. Much of the growth was due to the strong economy of the 17-county New York-New Jersey metropolitan area. The prognosis for 1985 is good. Although the strong dollar is hurting manufacturing, and a housing shortage and lagging infrastructure investment cause concern, economic growth is consolidating into a fundamentally strong base.

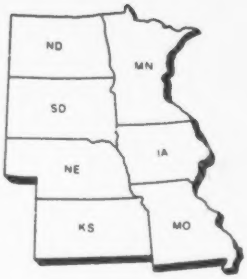
MID-ATLANTIC

SOUTHEAST

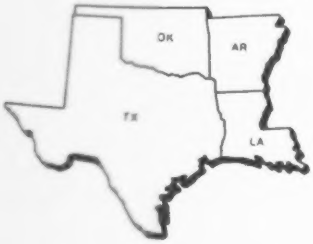
DE
MD
WV
VA
KY
NC
TN
SC
MS
AL
GA
FL

The economy of the Southeast continues to reflect the general trends of the national economy. Really fast growth has been confined to Florida and Georgia during the past two years and that pattern should continue. The economic picture for the other states is mixed. The middle south is experiencing the difficulties associated with older, declining industries, while Alabama, Mississippi and West Virginia continue to lag. Overall, the region's profile is becoming more like that of the nation and its prospects more similar to the national outlook.

These are troubled times for the nation's agricultural regions. Growing stocks of farm commodities, high real interest rates, sluggish farm export demand, and falling farm asset values are sapping the vitality of American agriculture. Farm income rebounded in 1984 but will be sharply lower in 1985. An improved farm economy is both a number of years in the future and importantly dependent upon improved national economic policies.



AMERICA'S
BREADBASKET

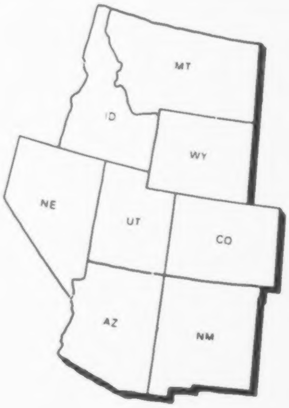


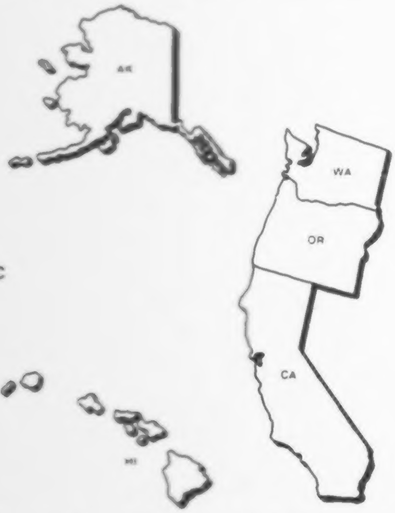
SOUTHWEST

Assuming continued national economic growth, the Southwest economy will continue to expand. However, growth will not be as strong as it was during the energy boom. Many parts of the region are undergoing fundamental structural adjustments in energy and energy-related industries, and these adjustments probably represent some permanent losses to the region's economy. The bright spots are concentrated in the rapidly growing high-tech industries located in Texas' "Silicon Gulch."

There are divergent trends in the Mountain region. The diversified economies of the southern tier of states have done well despite the energy boom's demise, but the resource-based northern states remain depressed. The sources of strength for the southern states are widespread and their outlook is for continued growth at least at the national average pace. But slow growth is likely to continue to characterize the northern tier for some time.

MOUNTAIN STATES





PACIFIC

The economies of the Pacific region fared well in 1984, mirroring the national experience. California had very strong growth, led by aerospace and electronics. Although high-tech industries are becoming more important in Washington and Oregon, their timber industry remains depressed. The region should perform marginally better than the nation in the next few years, with high-tech industries a positive factor and timber, energy and agriculture negative ones.

1

Constant Change is a Fact of Economic Life

Lora S. Collins

The meeting of the 1985-1986 Regional Economic Forum was held at a time when the national economic news was ambiguous. In general, the Forum members expected sustained—although not particularly strong—economic growth through 1985, with a very subdued inflation rate. While the Forum participants were worried about developments beyond the near horizon, however, their concern did not extend to the spelling out of any specific bleak scenarios. In fact, the anxiety level among Forum participants was quite low. Their most clearly articulated worry was that the economy would suffer some setback in 1986, but many in the group foresaw at worst a "growth recession," i.e., simply a deceleration of the economic growth rate.

Because of the general absence of serious concern over the national economy's condition and prospects, the Forum meeting focused with special clarity on the particular characteristics of the country's regions. A pervasive theme of the meeting was that rapid adjustment and change are a continuing fact of the American economy. Areas that have traditionally—or at least in recent decades—been considered as ailing are in good shape while those that seemed to be without a care are having difficulties. New York City and State are running fiscal surpluses while Texas has a deficit. Significant structural changes are underway—for instance, in the energy industries in the Southwest and Mountain regions, mining in the Mountains, lumber in the Northwest, old-line manufacturing in the Southeast, and in agriculture everywhere. But significant structural change has been a constant factor in American life: It is a real strength of the economy that hardly anything remains always as it was.

New England

Katharine L. Bradbury*
Federal Reserve Bank of Boston

The unemployment rate in New England has hovered around 4½ percent since last Summer. The region has not seen rates this low since 1970. Meanwhile, the national rate fell gradually from about 7½ percent last Summer to 7.1 percent in November, and has risen slightly since then. Rates in both New England and the nation have fallen 3½ percentage points since the recession trough in November, 1982, but the U.S. rate is still about a percentage point *above* the level in January, 1980, while New England's rate is a percentage point *below* the pre-recession peak. Thus, according to unemployment measures, the New England economy is booming, having recovered entirely from the two recessions of the early 1980's while the nation still has some way to go.

Figures on regional employment growth also paint a picture of a booming region. Total nonagricultural employment grew 11 percent in New England in the recovery through January, and 8 percent in the nation. (See table). Growth in all the New England states exceeded the national average. In Massachusetts and New Hampshire, both manufacturing and nonmanufacturing employment grew at a double-digit pace between November, 1982 and January, 1985. Job growth in the other four New England states was concentrated in the nonmanufacturing sector, especially construction and trade.

New England's strong employment growth is surprising because New England did not suffer as great an employment decline in the recession as did the nation. Viewing the entire period from January, 1980 through November, 1982 as one long recession, the contrast is quite striking: U.S. total employment declined by 2.3 percent but New England's fell only 0.5 percent. Taking this longer view, New England's current employment performance is quite impressive: as the table shows, neither the nation nor the region has regained January, 1980 employment levels in manufacturing; New England was down 1.5 percent, the nation 5.1 percent as of January, 1985. But with strong growth in the nonmanufacturing sector, total employment in New England increased 10.4 in five years, while in the nation as a whole it grew 5.7 percent.

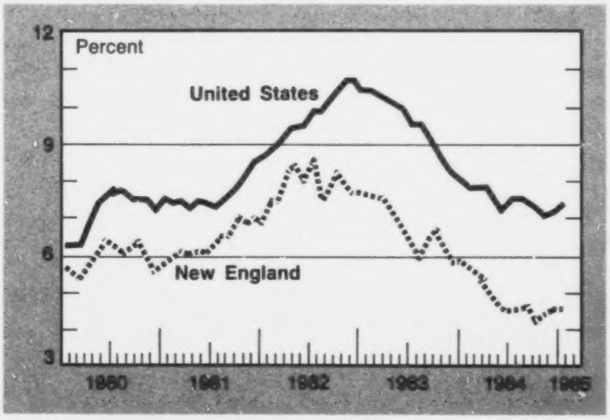
Taking an even longer view, personal income data also suggest that the New England economy is quite strong. In 1970, the average per capita income in the New England states was 109 percent of the U.S. average, roughly where it had been since at least the mid-1950's. It declined fairly steadily relative to the national average during the 1970's, hitting 103 percent in 1977, where it stayed through 1979. From 1980 to 1983, as recessions hit other regions quite hard, New England's relative position improved steadily. In 1983, per capita personal income in New England rose to 111 percent of the national average, the highest of any of the nine census regions.

Thus, on balance, New England's situation is quite favorable. Unemployment is low; employment has increased at a surprising pace; and personal income per capita is high. What can be said about the future? Assuming no big shocks in the national economy, New England's prospects depend most heavily on local labor-market conditions and three economic sectors important in the region—defense, exports and investment goods.

Defense promises to remain a steady source of employment strength in New England. In spite of the current budget debate, federal defense spending is likely to grow about 5 percent annually in real terms over the next few years, a faster pace than total GNP growth. New England particularly benefits from defense spending because it captures 11 to 12 percent of the nation's prime defense contracts, although it has only 6 percent of the nation's total employment.

The prospects for capital goods and exports are tied up with the strength of the U.S. dollar. Manufacturing in New England is more concentrated in industries responsive to business investment spending than is manufacturing nationwide. Based on surveys of capital spending plans, forecasters are expecting growth in equipment purchases to exceed total output growth rates over the next several years. This is good news for New England's durable goods manufacturers, but it would be better news if they and other domestic producers could be certain of capturing the lion's share of the spending increase. The problem is that imports have snagged over half the growth in capital equipment spending since the dollar began rising in 1981.

Chart 1:
Unemployment Rate—United States and New England



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*The views expressed are those of the author and do not necessarily represent those of the Federal Reserve Board or the Federal Reserve Bank of Boston.

Table 1: Percent Changes in Nonfarm Wage and Salary Employment in Recessions and Recovery—United States and New England

	Total	*Manufacturing*	*Durable Goods*	*Nondurable Goods*	*Manufacturing*
Two recessions and recovery 1/80-1/85					
United States	5.7	–5.1	–6.2	–3.4	9.0
New England	10.4	–1.5	NA	NA	15.0
Recovery 11/82 - 1/85					
United States	8.3	9.8	13.5	4.6	7.9
New England	10.9	8.3	11.2	2.7	11.8
Connecticut	9.0	4.6	4.6	4.8	10.7
Maine	8.7	0.4	12.8	–7.1	11.7
Massachusetts	11.5	11.4	15.7	3.3	11.6
New Hampshire	18.5	17.4	24.2	5.2	19.0
Rhode Island	9.1	5.8	4.1	9.5	10.5
Vermont	9.1	3.4	3.8	2.2	10.8

The problem is the same with exports. New England producers have historically exported a higher fraction of their output than the national average. Now that the recovery is fairly well established worldwide, these export-oriented industries should be booming, but the strong dollar obviously puts U.S. producers at a disadvantage in world markets, just as it does in those domestic markets where foreigners compete. Most forecasters are predicting some decline in the dollar over the next few years, although no big plunge. This should somewhat improve the situation for New England capital goods producers in general, and for those that have historically focused on exports in particular.

One other cloud on the horizon is that New England's growth may be constrained by labor shortages. While shortages of professional and technical workers are not new to New England, much of the region is now experiencing shortages of lower-level office personnel and sales workers. Low unemployment rates are one indication; in addition, anecdotal evidence of shortages in specific locations and occupations appears regularly in news stories.

At this point, it is not clear how the region will adjust. Wages are rising—the average manufacturing production worker's wage rose 7½ percent over the last two years in the nation, while the New England average rose 10 percent, bringing wages in the region to 93 percent of the U.S. average (up from 87 percent as recently as the beginning of 1982). These higher wages are likely to encourage some combination of increased net in-migration to the region, greater intra-regional moves (or longer commutes toward the tightest labor-market areas), and increases in the labor-force participation rate. If these responses are not enough, there will also be a slowing of employment growth, as hiring difficulties discourage firms from moving into, or expanding in, New England.

In sum, New England should fare quite well over the next few years. Overall, employment in the region is likely to grow more slowly than in the nation, but moderate employment growth should not be particularly troublesome for a region with population growth at roughly half the national rate in recent years. Unemployment rates should stay well below average, and per capita incomes are likely to hold their strength. Labor shortages are a "problem" that many regions wish they were facing.

"The Industrial Heartland"

Wynn V. Bussmann
TRW

The economic recovery that had begun to be felt in the Industrial Heartland faltered in the last half of 1984. Part of the weakness is explained by the slowdown in the national economy and part is explained by other reasons.

Total manufacturing employment nationwide grew at an annual rate of 6 percent in the first half of 1984 but slowed to a 1.5 percent rate in the second half. Because of the disproportionately high concentration of manufacturing in the economy of the Heartland, the effects of the general economic slowdown were magnified in the region. The region's manufacturing employment, which grew at a 4-percent rate in the first six months of 1984, is estimated to have shrunk at about a 1-percent rate in the last six. Furthermore, employment in nonmanufacturing failed to take up the slack so that growth in total nonagricultural employment slowed from about a 2.5 percent rate in the first half of 1984 to a 1.5-percent rate in the second half.

In addition to being highly manufacturing oriented, the Heartland economy is heavily oriented toward the production of durable goods of the traditional type. Although investment in new plant and equipment has been extraordinarily strong in the general economic recovery, the bulk of this strength has been concentrated in high-technology equipment (see table) and much of this is manufactured in other regions of the country.

The $11.3 billion increase in expenditures for high-technology equipment from 1983 to 1984 was approached only by the $8.9 billion increase in transportation equipment. Indeed, the $16 billion increase in expenditures for high-technology equipment since 1982 almost equaled the $16.5 billion increase in the sum of the other three categories. Such figures light up the eyes of regional developers.

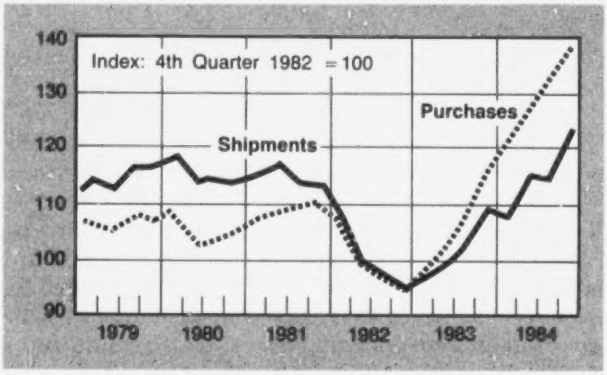
The Heartland's problems are secular as well as cyclical. In 1970, constant-dollar expenditures on high-technology equipment constituted 25.4 percent of the total of the four categories shown in the table. By 1984, that percentage had risen to 51.7 percent.

Table 2: Expenditures for Selected Types of Equipment (billions of 1972 dollars)

	High-technology	*Heavy Industrial*	*Trans-portation*	*Construction and Agriculture*
1978 . . .	33.3	25.8	30.7	10.9
1979 . . .	39.1	26.9	30.7	10.8
1980 . . .	44.9	26.3	23.9	8.5
1981 . . .	50.6	25.8	23.6	7.8
1982 . . .	52.8	21.6	21.2	5.0
1983 . . .	57.5	21.0	24.8	5.2
1984 . . .	68.8	24.9	33.7	5.7

Chart 2:

U.S. Purchases and Manufacturers' Shipments of Capital Equipment



Furthermore, it appears that the constant-dollar expenditures on items like computers have been seriously understated in recent years. The reason for this understatement is that the Commerce Department has been assuming a constant price deflator for computers when, in fact, actual prices have been falling—in recent years (since the introduction of the chip) by between 20 and 30 percent per year. When the Commerce Department gets around to restating history next December with a more accurate estimate of price deflators, investment in high-technology equipment will be shown to be an even larger proportion of the total.

The strong dollar is another reason for the economic difficulties of the Heartland region, as manufactured goods have lost competitiveness on international markets. In addition, local manufacturers have to contend with cheaper imports making inroads into what used to be their private domains. Thus, not all of the expenditures shown in the table were for domestically produced equipment. Since the trough in the fourth quarter of 1982, U.S. purchases of capital equipment have risen almost 40 percent while shipments from U.S. producers of capital equipment have risen only about 25 percent. The difference, of course, has been made up by imports.

The prospects for the economic rejuvenation of the Industrial Heartland in the near term are not bright. If the dollar stays strong, no relief from imports is in sight and the prospects for exports will not improve. If Congress slashes the budget deficit to bring down interest rates, and the dollar drops as a result, then the economy will probably be in a recession which, at least in the short run, will hit the Heartland especially hard.

Any improvement from a weaker dollar or from a switch to high-technology goods production will take time to be felt. Thus, while one can imagine a bright future for the region, that future seems at least many years away.

The Mid-Atlantic

Rosemary Scanlon
Port Authority of New York & New Jersey

The 1984 recovery was robust in both New York and New Jersey. All major economic indicators—employment, unemployment, personal income, retail sales, construction and the specialized business and office functions—recorded the best rates of improvement in well over a decade. What is more, the strong regional economy has led to a stabilization in population, in contrast to the declines registered during the 1970's, together with growth in the regional labor force. By year-end 1984, only a few key factors, such as the housing shortage and lagging infrastructure investment, gave cause for concern.

Table 3: Mid-Atlantic Economic Indicators

	New York	*New Jersey*	*N.Y.-N.J. Metropolitan Region*
Nonagricultural Employment			
Level in 1984 (thousands)	7,336	3,339	7,106
Percent change, 1983-1984	3.1	5.6	3.6
Manufacturing Employment			
Level in 1984 (thousands)	1,302	729	1,228
Percent change, 1983-1984	2.2	2.0	1.7
Unemployment Rate (%)			
1983	8.6	7.8	8.1
1984	7.2	6.2	7.0
Personal Income			
Percent change, 1983-1984	8.9	10.0	N.A.
Retail Sales			
Percent change, 1983-1984	11.5	10.3	11.3
Construction Activity[1]			
Level in 1984 ($ billions)	9.3	6.4	9.0
Percent change, 1983-1984	13.3	13.5	16.2
Air Passengers			
Level in 1984 (millions)	N.A.	N.A.	73.9
Percent change, 1983-1984	N.A.	N.A.	15.2

[1] Source: F.W. Dodge

Employment in the region rebounded sharply in 1984. The rise was a bit less in percentage terms than the national gain, but it came from a relatively high base that reflected the relatively mild regional impact of the 1981-1982 recession. In New York State, wage and salary employment in 1984 was up by 174,000, a gain of 2.4 percent, to a level of 7.46 million. In New Jersey, jobs increased by 116,000 or 3.4 percent, to an average of 3.26 million in 1984.

In both states, growth was led by the services, both personal and business, as well as trade, finance and construction. Manufacturing employment edged up from the recession, with jobs up 15,000, or 1.3 percent, in New York, and 22,000, or 3.1 percent, in New Jersey.

The strong job market and relatively fewer entrants to the labor force worked to push unemployment rates under the national average. In New Jersey, the rate fell to an average of 6.2 percent in 1984, down from 7.8 percent in 1983. In New York State, unemployment declined from an average of 8.6 percent in 1983 to 7.2 percent in 1984.

The construction industry was particularly strong. F.W. Dodge reports that the value of all construction awards reached $9.2. billion in New York in 1984, an increase of 13.3 percent over 1983—well above the national increase of 8.4 percent. New Jersey's construction industry was similarly buoyant, with contract awards reaching $6.4 billion, a 13.5 percent gain from 1983.

As a result of the strong job market, total personal income in each state increased by 9 percent in 1984 (based on data through the first nine months), and retail sales were strong, up almost 12 percent in New York and 11 percent in New Jersey.

Much of the region's economic strength was due to the strong economy of the 17-county New York-New Jersey metropolitan area, which saw a gain of 182,000 jobs, a rapid decline in unemployment rates (the region's unemployment fell to 6.1 percent by year-end 1984), and a strong business and finance sector that prompted an increase of 21 million square feet of new office space. Real estate leasing activity is strong, and the Manhattan central business district has one of the lowest office-vacancy rates in the nation. Tourist and travel indicators posted new highs for the year. The number of air passengers using the region's three major airports totaled 24 million, a gain of 29 percent in a two-year period.

The prognosis is good. Jobs are expected to increase, although less rapidly than the strong gains of 1984. Unemployment rates should come down quickly, including those in the central cities. Construction is expected to remain firm, with the only uncertainty in the housing sector; strong pent-up demand has yet to be matched by a sufficient increase in new housing, leading to shortages and rising prices for housing throughout the area. As unemployment falls, wage and salary gains will likely be large enough to lead to a brisk increase in personal income. However, the strong U.S. dollar is adversely affecting both states' manufacturing and export sectors, even though rising imports and depressed foreign-currency values have also contributed to lower inflation rates. In sum, 1985 should be a solid year, one in which economic growth is consolidating into a fundamentally strong income and fiscal base.

The Southeast

E. Blaine Liner
Liner Associates, Inc.

The economy of the Southeast continues to reflect the general trends of the national economy. For example, the region's unemployment dropped from 10 percent in 1983 to 8 percent for 1984; it can be expected to go even below that for 1985, if current trends continue. Although there was a general economic slowdown in the region during the last half of 1984, a turnaround during the closing months of the year has continued at a brisk pace in 1985.

With the exception of three problem states (Alabama, Mississippi and West Virginia), growth rates in income are higher than those of the nation. Really fast growth has been confined to Florida and Georgia during the past two years, and that pattern should continue well into the future. Florida and Georgia will again be national leaders in rates of increase in employment, income and retail sales, a repeat of the 1984 record-setting expansions in both states.

Florida accounts for one-third of the Southeast's income and, like last year, will be adding about 25,000 new residents per month during 1985; the growth from this one phenomenon—migration to Florida—accounts for much of the impressive data for this region. Georgia has many large national defense installations and related manufacturing plants; Atlanta has increasingly dominated other cities as the region's capital city; and automobile manufacturing is a major Georgia industry. All three factors weighed heavily in the 1984 increases and contribute greatly to the positive economic outlook for 1985 and beyond. While both states are very favorably situated in the defense industries, their tourism and recreation sectors were highly profitable in past years and are expected to be very important in the future.

The economic picture for the other states is mixed. The middle South is heavily dominated by older, basic industries such as textiles, apparel, tobacco and furniture. As long as this is the case, that area will continue to experience the difficulties associated with declining industries, especially competition from imports. Heavy capital spending for plant modernization in each of these industries during 1984 not only spurred the construction sector but will help take these industries to more internationally competitive levels of productivity. Employment in textiles, for instance, is now at the lowest point in two decades but output is up. The future of these industries now enters the phase where the only avenues left for improvement are likely to be political—import-export issues and the strength of the dollar overseas, regulatory issues, and the health questions and governmental actions related to tobacco and smoking.

Despite these structural considerations, the migration to the region is so strong as to mask most problems. Data indicating any downside trends often get swamped by the data reflecting the arrival of new residents, and the new construction, new services, and additional spending that comes with them. Therefore, income growth is expected to continue at least at the national rate and probably a bit higher. This has been the pattern in the recent past and there is little evidence to support any other conclusion. Capital spending in the region is up; personal income is up; and 1984 witnessed healthy increases in the nonmanufacturing employment that contributes to the diversification of the regional economy.

Financial markets are in great flux and can be expected to be even more competitive as regional reciprocal interstate-banking laws become operational this coming July. Most financial institutions, large and small, have been hard at work on their options and plans for merging, selling and buying. They are looking forward to a rather invigorating shakeout period commencing this Summer. As a result, we can expect greater access to the large national and international capital markets, a change that can only help the traditionally capital-poor Southeast.

The building or expansion of plants by foreign firms continues to play an observable role in the southeastern economy. North Carolina, for example, had over 50 new or expanded plants in this category during 1984. Many of them are in sectors that add balance and diversification to the economic base, for instance, electronics, electrical machinery, and other high-technology areas.

The construction, finance, trade and service sectors, especially business services, continue to exhibit above-average growth, helping to pull much of the economy out of the 1982-1983 recession. A very slow but steady transition of the structure of the southeastern economy away from its historical profile in basic manufacturing and natural resource exploitation can be seen in the cyclical surges, which are nearly always associated with large growth in nonmanufacturing production.

Although it is difficult to conceive of an even lower level of agricultural employment, it should be expected. Now in its third decade of precipitous fall, agricultural employment will go even lower as tobacco farmers brace for a loss of price supports, markets, or both—adding an additional group of farmers to those already retrenching due to uneconomic production-unit sizes. This will, of course, be most strongly felt in the local economies along the "tobacco road."

In summary, the Southeast will continue to mirror the national economic performance to a great extent. Within this general pattern, Florida and Georgia will be the regional leaders, and Alabama, Mississippi and West Virginia will perform at the lower end. Continued evolution of the regional economy's structure toward nonmanufacturing will be in evidence. Historically, the southeastern economy was countercyclical because of its "colonial" characteristics. It is now beginning to perform more in step with the nation.

Federal Government decisions will have a major impact on the performance of the economy in terms of exports, defense expenditures, and agricultural policy. A major unknown will be the impact on the economy of state and local government expenditures for capital goods, construction and employment. Major cutbacks in federal funds as part of the deficit-reduction program, affecting programs such as general revenue sharing, would have a measurable regional impact on this large sector of the southeastern economy.

"America's Breadbasket"

Marvin Duncan*
Federal Reserve Bank of Kansas City

These are troubled times for the Breadbasket. While 1984 yielded sharply higher farm income, the year ahead promises to be one of renewed decline in farm income. Growing stocks of farm commodities, high real interest rates, sluggish farm export demand, and falling farm asset values are sapping the economic vitality of American agriculture and the spirit of its farmers. Although in part an inevitable result of a changed economic climate, these circumstances have resulted in serious financial stress for a growing proportion—albeit a minority—of America's farmers. An improved farm economy is both a number of years in the future and importantly dependent on improved national economic policies.

America's farmers were heartened by a near doubling of net farm income in 1984, to about $31 billion. Even in inflation adjusted 1972 dollars, this represented an income level nearly as high as that reached in 1981, the most recent previous year with relatively favorable farm income. The farm income improvement in 1984 was, however, dependent on large increases in farmer held stocks of crops and direct government payments of $7-10 billion.

The year ahead promises to be one in which net farm income tumbles sharply to the $21-22 billion range (Chart 3). In 1972 dollars, net farm income will be back to the $8-13 billion range that has characterized the decade of the 1980's. Some improvement in both crop and livestock receipts in 1985 will only about offset a forecasted sharp drop in government payments. Inventory change will not add to farm income and production expenses will increase. Net cash income—the difference between cash income and cash expenditures—will decline for the second consecutive year, posing increased problems for farmers in meeting obligations for production costs and debt service.

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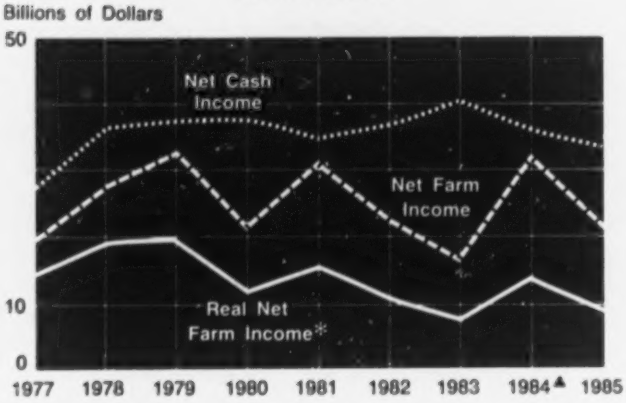
*The views expressed are those of the author and do not necessarily represent those of the Federal Reserve Board or the Federal Reserve Bank of Kansas City.

Chart 3:

Farm Income



*Measured in 1972 dollars ▲Estimated

Source: U.S. Department of Agriculture

The impact of reduced farm income in 1985 will not be shared uniformly across the sector. Livestock profits should improve compared to 1984 as a result of higher prices for meat animals and lower feed costs. Receipts of poultry and egg producers will decline while dairy product receipts will hold steady. Crop profits will likely decline as crop prices slide below year-earlier levels during most of 1985. Food and feed grain receipts may improve slightly on the basis of higher production, while oil seed crop receipts will decline because of sharp price reductions. Cotton receipts will decrease substantially due to lower cotton prices. Vegetable and fruit receipts may be down slightly, as well.

Farm export sales will decline in 1985 to about $35.5 billion, as lower commodity prices more than offset an increase in tonnage shipped. The gloomy export picture extends through 1985 and likely for at least a few more years. In 1986, both value and tonnage exported will decline from this year's levels, a discouraging note to U.S. farmers increasingly dependent on growth in export markets for farm prosperity.

Increasing evidence that U.S. rice, wheat, and cotton prices may sometimes be uncompetitive in world markets should cause government policymakers to more closely link government price supports to world market clearing prices. Despite farmer reluctance to accept that change in farm policy direction, a move toward market orientation appears necessary if the slide in farm export sales is to be reversed.

Although bad news for farmers, softer commodity prices are good for consumers. Food price increases in 1985 will moderate from 1984, running in the 2 to 5 percent range and below the general inflation rate expected for the year. Indeed, the farm value of food will likely register a decline in 1985. Consequently, U.S. consumers will spend only 14.6 percent of their disposable personal income for food in 1985, down from 16 percent in 1981 and arguably the world's best food bargain.

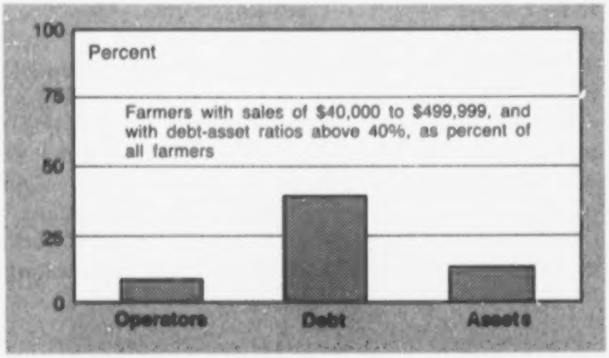
U.S. agriculture is in the midst of a difficult transition to a more austere economic climate as a result of the mature domestic market for food and fiber, relative price stability, financial market and transportation deregulation, and increased dependence on export markets in a world economy that currently exhibits only very slow growth. This transition has been made more difficult than necessary by the perverse impact of huge secular federal budget deficits on interest rates and thus on debt carrying costs and export competitiveness. As a consequence, farm asset values will continue to decline in 1985. Across much of the nation's agricultural heartland, farm land values have already fallen by 25 to 35 percent from their previous market peak in 1981. Further declines to about 50 percent of 1981 levels appear likely over the next one to three years.

Low farm product prices and declining asset values have surrounded heavily indebted farmers with a rapidly moving pincer action. Farmers with heavy indebtedness, relative to assets owned and farm cash flow, have been unable to service their outstanding debt satisfactorily. At the same time, declining asset values have diminished their creditworthiness. Some 210,000 farm operators with annual sales between $40,000 and $499,999—a classification that encompasses the core of the nation's commercial family farms—have debt-to-asset-ratios over 40 percent and likely are experiencing problems in servicing outstanding debt. This group, which represents about 9 percent of all the nation's farm operators, holds 14 percent of farm operator assets and 39 percent of farm operator debts (Chart 4). About 92,000 of these farm operators have debt-to-asset ratios exceeding 70 percent; for these, the outlook is grim. They most likely will be forced from business within the next two to three years. In the Tenth Federal Reserve District, farm failures and partial liquidations have been running about three times the rate bankers consider normal.

Farm financial stress and declines in farm asset values appear to be most acute in the nation's heartland where weather-induced production problems have undermined farm profitability in recent years. The problem is, nonetheless, national in character with only the northeast relatively unaffected. Farm problems have spilled over into agribusiness and

Chart 4:

Farm Debt and Assets



Source: Federal Reserve Board of Governors.

farm lending. In the Tenth Federal Reserve District, data indicate one-fifth of rural nonfarm businesses are experiencing severe financial stress. Sales by farm capital goods manufacturers are off sharply and the U.S. farm equipment industry is currently operating at about 40 to 50 percent of capacity. U.S. grain exporters are operating at only about 60 percent of capacity. Thus, profit margins for most rural and agribusinesses are very tight—and in many instances negative.

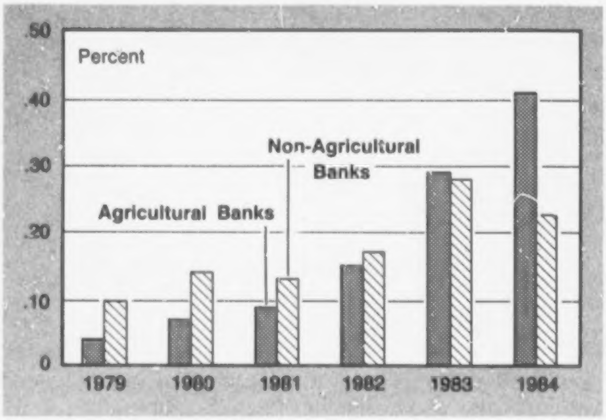
Agricultural lenders have experienced sharp increases in loan problems. Agricultural banks across the nation, in just the past two years, have changed from having substantially lower loan chargeoffs than nonagricultural banks of comparable size to having substantially higher loan chargeoffs (Chart 5). The trend toward higher loan chargeoffs appears to continue in 1985. While both the rural banking system and the Farm Credit System have sufficient resilience to ride out the troubled times in agriculture, failures of agricultural banks and Production Credit Associations increased sharply in 1984—but from extremely low levels. Moreover, heightened levels of failures appear likely in 1985.

In summary, U.S. farm income will be sharply lower in 1985. Crop producers will experience reduced profits while most livestock producers should have improved profits. Protracted income pressures and markedly higher inflation-adjusted interest rates have, in recent years, caused substantial reduction in farm asset values and resulted in serious financial pressures for heavily leveraged farmers and agribusinesses. Loan losses for agricultural lenders have escalated and are expected to climb higher in 1985. No prompt turnaround in farm sector profitability is in prospect, as the sector continues to be buffeted by slow world economic growth, increased competition in world markets, and the adverse effects of unprecedented peacetime federal budget deficits.

Chart 5:

Net Charge-Offs as Percent of Total Loans

First half of year



Source: Federal Reserve Board of Governors.

The Southwest

Bernard L. Weinstein

John Gray Institute

Nineteen eighty-four was a good year for the nation but an uneven year for the southwestern states of Texas, Oklahoma, Arkansas and Louisiana. As the national economy moved from rapid recovery to steady expansion, the region began to recover some of the job losses stemming from the 1982-1983 recession and the decline in oil prices. But most of the employment gains were recorded in Texas, with only moderate growth in the other three states.

During 1984, the unemployment rate dropped in Texas, Arkansas and Louisiana but rose slightly in Oklahoma. As the new year began, all of the states in the region, with the exception of Texas, were posting unemployment rates higher than the national average, and Louisiana was one of only five states in the nation with a double-digit unemployment rate.

The outlook for 1985 is cloudy at best. Because of the fairly rosy prognosis for the national economy, the region should continue to record gains in employment, income, construction and sales, although growth will not be as dynamic as during the energy boom of the late 1970's and early 1980's. Rising defense expenditures, especially for aerospace equipment, will provide a hefty boost to parts of Texas, especially the Dallas-Fort Worth area.

However, many parts of the Southwest are in the throes of a fundamental structural adjustment process, not dissimilar to that being experienced by the Midwest, that seriously constrains short-term growth prospects. During the 1970's, the Southwest rode to prosperity on the back of manufacturing, much of which was concentrated in industries either directly or indirectly dependent upon a healthy energy sector—industries such as petrochemicals and oil refining, fabricated metals and machinery manufacturing, and shipbuilding. Employment growth in these energy-related industries was rapid and, because the jobs were generally high-paying, a con-

Table 4: Unemployment Rate—United States and Southwest

	1984 Average	January 1984	January 1985
United States . . .	7.5%	8.8%	8.0%
Texas	5.9	7.3	6.9
Oklahoma	7.0	7.9	8.2
Arkansas	8.9	10.5	8.6*
Louisiana	10.0	10.9	10.4*

*December 1984

siderable amount of purchasing power was injected into the regional economy. Moreover, the growth of energy-related manufacturing employment had a profound positive effect on other sectors, notably construction.

Since 1981, however, the Southwest has suffered substantial losses in the very same industries that were the engines of growth through the 1970's. Between 1981 and 1984, the region as a whole lost nearly 180,000 manufacturing jobs, over 10 percent of its industrial base. The largest relative loss, 18 percent, was recorded in Louisiana. Arkansas, by contrast, witnessed a slight gain, a reflection of its stronger dependence on light, labor-intensive manufacturing.

Table 5: Manufacturing Employment in the Southwest

	December 1981	December 1984	Percent Change
	(thousands)		
Southwest . .	1737.5	1559.7	–10.2%
Texas	1113.4	995.6	–10.6
Oklahoma . . .	198.3	174.1	–12.2
Arkansas . . .	203.2	207.4	2.1
Louisiana . . .	222.6	182.6	–18.0

Most of the Southwest's manufacturing-employment retrenchment is a reflection of structural adjustments in the energy sector, and probably represents a permanent loss to the region's economy. The continued softening of oil prices since 1980 has depressed the drilling activity that would otherwise stimulate the region's fabricated-metal and machinery industries. At the same time, steadily declining domestic demand for gasoline and other refined products, as well as the emergence of more efficient refiners in Western Europe, the Caribbean, and North Africa, has encouraged the reduction of refining capacity. (Nearly 50 refineries in the Southwest have shut down or substantially reduced capacity since 1980.) The outlook for the region's chemical industry is also uncertain as foreign competitors are beginning to serve the market for basic feedstocks.

Further declines in oil prices may pose additional problems for the Southwest's economy. Although the experts were predicting "eighty-five in eighty-five" several years ago, the price of oil seems more likely to hit $25 a barrel than $85 a barrel this year. Substantial job losses were recorded during the 1982-1983 downturn in the "Oil Patch." The recovery, which began in late 1983, already shows signs of being aborted as oil prices resume their fall.

Fortunately, there are some bright spots on the horizon for the Southwest during 1985 and 1986. Most of the region's recent job growth has occurred along the Interstate 35 corridor, between Dallas-Fort Worth and San Antonio. This corridor, sometimes referred to as "Silicon Gulch," has become one of the nation's hot spots for high-tech industrial development. At 3.5 percent, Dallas-Fort Worth currently boasts the lowest unemployment rate among the nation's large metropolitan areas and will lead the nation in construction activity during 1985, and probably also in 1986. Austin is emerging as an important research and development center, and San Antonio has recently launched several programs to establish itself as a premier location for biotechnology research and commercial applications.

The Mountains

Lucy Black Creighton*
First Interstate Bank of Denver

The Mountain region continues to be marked by divergent trends. Arizona, Colorado, Nevada, New Mexico, and Utah, which comprise the southern tier of Mountain states, have recovered from the 1981-1982 recession at or above the national average, with substantial growth in service industries, high technology, and other state-of-the-art manufacturing. Although hard-hit by the demise of the western energy boom, the diversified economies of these states have more than offset the losses from energy.

In contrast, the more northern of the Mountain states—Idaho, Montana and Wyoming—remain heavily dependent on mining, forest products, and agriculture, and have been unable to shake off the effects of declining prices for oil and natural gas, wood, agricultural products, metals and coal.

The performance of the southern tier of states over the past two years is especially impressive in light of the braking effect of the downturn of oil prices. By November, 1984, U.S. nonagricultural wage and salary employment was 4.9 percent above its September, 1981 peak. For Arizona, the comparable gain was a whopping 18 percent, and even for Colorado, New Mexico and Utah—which were heavily involved in energy—the gain was in excess of 5 percent.

Other indicators confirm this sturdy performance. By late 1984, unemployment rates, which averaged well above 8 percent in 1982 and 1983, had fallen to less than 5 percent in Arizona, to 5.6 percent in Colorado, to 6 percent in Utah, and to close to 7 percent in New Mexico. Only Nevada showed a still-high 8 percent.

Led by Arizona, these same states achieved a gain of 1.5 percent in nonagricultural wage and salary employment in 1983, compared to a national increase of 0.6 percent. In 1984, the five states showed an estimated nonfarm employment growth of 4.6 percent, essentially equal to the national average of 4.5 percent.

Personal income also showed substantial gains, with average increases of 7.2 percent and 10.5 percent in 1983 and 1984, respectively, compared with nationwide increases of 6 percent in 1983 and just under 10 percent in 1984.

Lower mortgage rates made 1983 a banner year for housing in all five states, with new units up by 67 percent. While gains in 1984 were decidedly less spectacular, only Colorado and Nevada showed a decrease in new housing units compared with 1983.

The outlook for 1985 and 1986 is good. Assuming the national expansion does not falter, nonfarm employment in these states should maintain its advantage over the national average to achieve an average 4.3-percent growth rate for 1985 and something close to that in 1986. Following a 7-percent jump in employment last year, Arizona will again rank highest in growth in 1985, at a rate close to 6 percent.

Given the very rapid advance in housing over the past two years, housing in 1985 will generally be flat to down, with the overall variation closely tied to the trend of interest rates and to the progress of the national economy. Personal income should rise by 10 percent in 1985, and by an equal percentage in 1986.

Nonresidential construction shows continued gains in both Phoenix and Denver, the two largest urban areas in the Mountain region. In Phoenix, above-average employment growth supported a 50-percent increase in the value of nonresidential construction in 1984, with prospects for another 25-percent gain in 1985. In Denver, a 25-percent vacancy rate has dampened office building, but Denver's industrial and retail construction showed substantial gains in 1984, and the higher levels are expected to be maintained through 1985.

The sources of strength for these five diversified western states are widespread, and the longer-term outlook is for continued growth at or above the national average. Population growth rates are more than double the national rates and, for the 1980-1984 period, all these states were among the 10 fastest growing in the nation. Although they show strongly the effect of the national shift to an information and service-oriented economy, manufacturing is an important source of strength. Contrary to the national trend, which shows declining manufacturing employment, manufacturing jobs continue to rise in these states. In Phoenix, for example, manufacturing represents approximately 16 percent of metropolitan area wage and salary employment, and in 1984 and 1985 will show growth rates averaging 8 to 8.5 percent. The situation in Denver is similar, although the annual average growth rate of manufacturing jobs is a less-spectacular 5 percent. Most of this growth is in the high-technology manufacturing sector.

Along the northern tier of the Mountain region, Idaho, Montana and Wyoming have seen relatively few benefits from the 1983-1984 national economic expansion. Although prospects are looking up and unemployment rates have fallen substantially, nonfarm employment has yet to regain its pre-1980 high. The collapse of the energy boom, and especially of oil and gas exploration and development, was a severe loss. Furthermore, the important lumber and wood

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*The author wishes to thank Jeffrey A. Haas, Regional Economist at First Interstate Bancorp in Los Angeles, for his assistance with this report.

Table 6: Mountain Region Economic Indicators

		1984	*1985*	*Percent Change*		
	1983	*(estimate)*	*(forecast)*	*1983*	*1984*	*1985*
Arizona, Colorado, Nevada, New Mexico, Utah,						
Nonfarm employment (thousands)	3,835	4,011	4,183	1.5	4.6	4.3
Housing permits	162,418	164,988	148,300	67.0	1.6	−10.1
Personal income ($ millions)	110,800	122,396	134,442	7.2	10.5	9.8
Population (thousands)	10,011	10,221	10,425	2.4	2.1	2.0
Idaho, Montana, Wyoming						
Nonfarm employment (thousands)	791	803	814	−1.2	1.5	1.4
Housing permits	14,095	12,253	11,600	47.0	−13.1	−5.3
Personal income ($ millions)	23,700	26,069	28,294	4.9	10	8.5
Population (thousands)	2,320	2,336	2,359	1.3	.7	2.9

products industry, hit first by the 1980-1982 downturn in housing, is now experiencing a prolonged decline in lumber prices. And agriculture in these states, as in the rest of the United States, is facing the difficulties of lower prices, reduced exports, and sharply declining land values.

Reduced rates of growth are likely to continue for some time in these heavily resource-dependent states. Long-standing industries are undergoing fundamental change, and relatively small and dispersed populations offer little opportunity for significant diversification. Declining oil prices will restrain the resurgence of oil and gas activity. Reduced rates of growth of electricity usage have cut the demand for coal. Hard-rock mining is facing competition from foreign sources of supply, as well as from downsizing and substitution of new and lighter materials in construction and in the production of automobiles and heavy equipment in general.

While the outlook for these three states is not very encouraging from a purely growth perspective, there is a brighter side. Employment growth was positive in 1984, unemployment rates are at or below the national average, and new housing construction has been substantial. Personal income also has shown steady growth, although per capita incomes in recent years have declined as a percent of the national average. The 1985-1986 outlook is for further improvement. Employment growth should average 1 to 2 percent both this year and next, with personal income gains at the 8.5-percent mark. Idaho, in particular, had a good 1984, which bodes well for further gains in 1985 and 1986.

The Pacific

Thomas D. Thomson
Crocker National Bank

The economies of the Pacific Region—Alaska, California, Hawaii, Oregon and Washington—fared well in 1984, mirroring the experience of the nation as a whole.

California, representing three-quarters of the entire region's population and employment, posted very strong economic gains in 1984. An additional 420,000 people were employed in the state in 1984, the greatest increase since 1978. The state's strongest growth industries continue to be the high-tech-related industries of aerospace and electronics. The aerospace industry—defined as firms producing commercial and military aircraft, guided missiles, and space vehicles—has grown at an annual rate of 13 percent in the last quarter, and currently employs about 215,000 people, or roughly 11 percent of the state's manufacturing work force. The future of this industry is expected to continue to be bright, with steady gains due to a continuing rise in defense spending, the success of the space shuttle, and additional capital outlays by the private sector for satellites. Contrary to some news stories, employment in the state's electronics industries rose in 1984. Preliminary figures indicate that employment in electronics grew 6.5 percent in 1984. Two factors will likely slow this rapid advance in the next few years, but growth will nonetheless remain positive: First, the industry is starting to go through a shakeout as the many firms that rapidly entered in the last several years compete for a limited commercial and personal computer market; second, and in the more immediate term, an inventory imbalance in semiconductor chips needs to be worked out.

As is the case in California, high-tech industry is becoming increasingly significant to the local economies in Washington and Oregon. The solid growth in nonfarm employment of roughly 3.5 percent over the last year in both these states is partly due to this.

In Washington, commercial aircraft production remains

Table 7: Pacific Region Economic Indicators

	United States	*Pacific*	*Alaska*	*California*	*Hawaii*	*Oregon*	*Washington*
Population (millions)							
1982	232.3	33.1	0.4	24.7	1.0	2.7	4.3
1983	234.5	33.6	0.5	25.2	1.0	2.7	4.3
1984	236.6	34.2	0.5	25.6	1.0	2.7	4.4
Nonfarm Employment (millions)							
1982	89.6	13.0	0.2	9.8	0.4	1.0	1.6
1983	90.1	13.2	0.2	10.0	0.4	1.0	1.6
1984	94.1	13.9	0.2	10.6	0.4	1.0	1.6
Unemployment Rate (%)							
1982	9.7	10.1	10.0	9.9	6.7	11.6	12.1
1983	9.6	9.7	10.5	9.7	6.4	10.9	11.2
1984	7.5	8.6	10.6	7.8	5.8	9.4	9.6
Personal Income ($ billions)							
1982	2584.6	407.7	7.5	311.6	11.6	27.1	50.0
1983	2744.2	435.3	8.2	333.7	12.4	28.6	52.4
1984	3012.0	481.5	9.1	371.1	13.3	31.2	56.8
Housing Permits (thousand units)							
1982	1351.0	122.4	8.0	84.8	5.7	7.1	17.0
1983	1602.0	223.7	11.2	171.9	4.8	8.6	27.2
1984	1647.0	268.4	6.5	218.0	5.4	8.0	30.5
Farm Receipts ($ billions)							
1982	144.8	19.7	0.02	14.4	0.5	1.8	3.0
1983	138.7	18.8	0.02	13.5	0.5	1.7	3.1
1984	141.4	19.8	0.19	14.3	0.5	1.8	3.0

an important force in the economy through direct and indirect employment. The outlook for this industry is bright as pressures mount for carriers to restock their fleets. The current lack of used aircraft will enhance sales of new equipment by carriers that must meet federal noise guidelines and growing demand for their services.

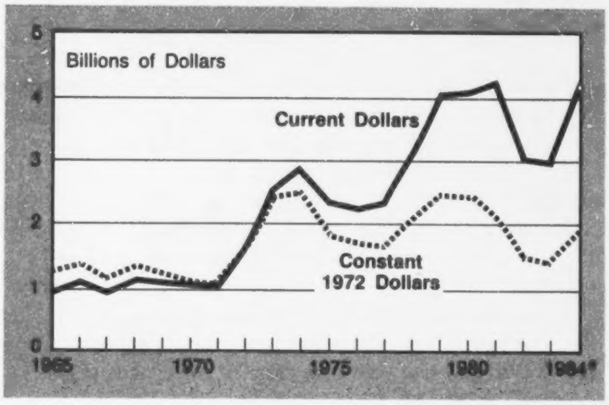
In Oregon, major efforts to lure new businesses into the state, especially high-tech-oriented ones, have been successful. Several Japanese firms have recently announced their decisions to locate in Oregon. The removal of the unitary tax law has been very important in this effort, in both effect and intention. Other factors include inexpensive property and the availability of skilled and relatively inexpensive labor. In addition, some analysts cite the very restrictive zoning laws in the state as a favorable factor in attracting companies to the region. This is because land uses have been carefully defined in the state with much of the land, in effect, preapproved for industrial building—minimizing the amount of red tape involved with development.

On a less positive note is the timber industry, a major business in northern California, Oregon and Washington. There is a current oversupply of lumber, which is due to a surge of imports from Canada, Brazil and Venezuela, the strong U.S. dollar, and less demand for wood in home construction. As a consequence, mills have shut down and timberland values have plummeted. Falling interest rates and last year's surging residential building have done little to help this situation. In the near term, the industry may receive some temporary help from the Timber Contract Relief Bill, which releases timber companies in the Northwest from federal timber-cutting contracts signed prior to the sharp drop in timber prices four years ago. However, the long-term outlook is not good.

Because of distress in the timber industry, growth in Oregon and Washington has been unevenly spread between the urban and rural areas. The urban areas are receiving the benefits of new high-tech-oriented industries while many of the rural areas, dependent on timber, have experienced little recovery. In addition, the primary metals and shipbuilding industries in Washington have been severely hurt by rising production of metals in third-world countries and a fairly dormant domestic shipping industry, respectively. The strong dollar has exacerbated these problems.

Tourism, an important business in all five states of the Pacific Region, has been disappointing except in Hawaii and Alaska. The disappointing flow of tourists to California, Oregon and Washington is partially due to the strong U.S. dollar, which has made traveling abroad particularly attractive to Americans while it has kept foreigners from coming into the United States. Falling air fares have also made travel to distant places more affordable to many Americans, adversely affecting domestic travel. In California, two major tourist events—the Summer Olympics in Los Angeles and the Democratic National Convention in San Francisco—were both disappointing in attracting record numbers of visitors. Adverse publicity prior to the events, and warnings of oppressive crowds, turned many people away from these events. In Hawaii where tourism is the number-one industry, the visitor industry has been exceptionally strong. This, in turn, has rippled through the entire economy, leading to an unemployment rate in 1984 of only 5.8 percent.

Chart 6:
California Net Farm Income



e = estimate

Agriculture is another very important industry in the region that has been experiencing difficult times. Although conditions vary among crops, it is fair to say that many farmers are currently grappling with product prices that have not kept up with production costs, low land values, and heavy debt burdens. In addition, the high value of the dollar has placed domestic farmers at a competitive disadvantage both abroad and at home.

Particularly hard hit by these problems have been California's specialty crops, most notably grapes. In addition to these adversities, however, the grape industry has had a problem of excess supplies, due in large part to an inherent three-to-five-year lag between planting and initial production. In the late 1970's, industry analysts expected consumption to continue to grow, following the impressive gains in table-wine and raisin-grape consumption during the 1970's. Consequently, plantings flourished. However, market conditions changed and the expected increase in demand for grapes did not materialize. Hence, the overzealous plantings of the early 1980's, which will soon become productive vineyards, will likely increase the current surplus even further.

The situation is not as dismal for many of the state's nonspecialty crops. Farmers of these crops have been better able to withstand these pressures due to their efficiency relative to domestic and foreign competitors. For this same reason, California farmers will likely be less hurt by the almost certain changes in federal farm policies, which will greatly alter the level of support that farmers have become accustomed to.

In Alaska, economic growth will be positive in the near term, although at a pace much less robust than in the last few years. Construction is expected to remain weak, with moderate growth in the service sectors. Government spending will continue to play a less vital role in leading the economy, with private spending picking up the slack. The economic outlook in the longer term is cloudy, due to the state's dependence on the oil industry and the current uncertainty associated with oil prices.

Finally, all of the economies of the Pacific region will benefit from the growing ties of the United States to the Pacific Asian economies, most notably Japan, Korea, Taiwan, the People's Republic of China, Hong Kong, and Singapore. Trade continues to grow, directly benefiting the transportation industries and ports of Seattle, Portland, San Francisco, Los Angeles and Long Beach, and indirectly benefiting myriad other trade and service industries. The potential for strengthening these relationships is quite good.

In sum, the economies of the Pacific region are expected to perform marginally better than the nation as a whole in the next few years, although the region's performance margin will narrow. Aerospace and electronics will continue to be strong influences, while timber, agriculture and oil will exert negative pressures. Tourism will remain strong in Hawaii and Alaska, two states which have been able to overcome the strong dollar's negative influence on domestic travel, while tourism in California, Washington and Oregon will remain weak.

ERRATUM

In Table 1 on page 7 the far righthand column which reads "Manufacturing" should have been labeled "Nonmanufacturing".

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The Conference Board
Research
Bulletin

No. 185

Business in the Community

Where Vanguard Companies Are Focusing

by Leonard Lund

Management Summary

- Community issues attracting most corporate attention and involvement in the past year were local economic development, primary and secondary education, health care, unemployment and job training, and arts and culture.

- Over the next two-to-five years, involvement will be in "people" issues—primary and secondary education, problems of the aging, and health care.

- CEO involvement growing in economic development, arts and culture, and primary and secondary education.

- Changing perception of community affairs' function toward bottom-line impact, "investment" of corporate contributions, and active influence on public policy.

CORPORATE RELATIONS PROGRAM

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The Conference Board
Research
Bulletin

Business in the Community: Where Vanguard Companies Are Focusing

The Conference Board frequently queries corporations to determine their positions on various community affairs issues and practices.[1] Most often, there is no standard response that can be attributed to the business community. Rather, each business, reflecting its corporate culture, environment and current leadership will, at a particular time, identify and give priority to the issues that affect it. However, there are communities of interest that bring businesses together in common actions.

Factors Affecting Corporate Responses

Aside from an individual corporation's philosophy —and that of its leadership—a whole series of outside factors help frame corporate response to various community issues. Obviously, some of these involve the local social and economic environment and the relationship between the business and the community. Others may include national social, political and economic conditions that fashion the current social fabric. According to Madelyn Hochstein, Senior Vice President of Yankelovich, Skelly and White, the current social and political climate may be termed the "Era of New Maturity." Mrs. Hochstein believes the characteristics of the period include a sense of tempered optimism about the future, and a strong concern for the "bottom line." The latter generates the need to make strategic choices and trade-offs in the allocation of corporate resources. Summarizing the results of a 1984 survey she conducted of a group of corporate CEO's, corporate leaders anticipate greater commitment to community and socially directed activities. They are also becoming more interested in affecting the public policy debate on such social issues as education and health care delivery—particularly where they perceive a lack of action on the part of public policymakers.[2]

The heightened level of involvement by chief executive officers was also discussed during a meeting of The Conference Board's Community and Public Issues Council, a group of senior community and public affairs executives from major corporate Associates of The Conference Board.[3] This session dealt with changing aspects of the community relations function and the role of community affairs officers. Discussion was based upon the findings of an informal survey of a small group of these officers from major companies. The findings of the informal survey, highlighted by the discussion, strongly indicated that the role of the corporate community relations executive is increasingly aimed toward "activism," particularly in the public policy arena.

The Community and Public Issues Council suggested that it would be useful to survey major corporations in order to develop a current record of community issues in which corporations are involved—either in programs of their own or as partners in local coalitions. This profile of corporate community concerns identifies current issues by the level of priority firms assign to them, traces the evolution of these concerns, and examines the various modes of response.

Public affairs or community affairs officers of major corporations were asked to rank the top five community-related issues only in their headquarters community, in which their company had had some active involvement in the past year. Based on responses from 140 companies, the five choices selected from a list of major issues, were tabulated in three ways: (1) the number of times they were mentioned as first-to-fifth choices (based upon the extent of corporate involvement); (2) the cumulative total of the number of times an issue was listed as *any* of the five choices (3) scoring and averaging each mention according to the priority of choice—the first choice given five points and the fifth choice, one point. Since both the cumulative total method and scored average method produced the same rankings, only the results of cumulative total were used.

Examining Community Needs

The survey responses indicate that major needs of most communities are essentially similar: They include the need for expansion of the economic base, either through attracting new industry or by stimulating the growth of local businesses; the need to improve schools; the need for and the high cost of health care facilities and services. Communities also face the need for job training and for lowering unemployment rates.

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[1] For example, Leonard Lund, *Issues in Economic Development, Stimulating Local Leadership and Resources.* The Conference Board, Research Bulletin No.175, 1985.

[2] Madelyn Hochstein, *Social and Political Issues Today,* Presentation to Corporate Contributions Seminar of The Conference Board, January 15, 1985.

[3] Community and Public Issues Council (formerly the Business Urban Issues Council) of The Conference Board. Unpublished remarks from a meeting on November 1, 1984.

These are the basic kinds of issues in which most companies become involved. Except for some unusually pressing local need, the community issues to pursue are chosen from this array by the individual companies.

Industry differences in the selection of community issues may, however, indicate that some motivations other than community needs are at work. The most apparent motives are self-interest and a perceived level of competence. This underscores the view that business involvement is most likely to be devoted to issues that have an impact on company interests, or to issues in which the company or its personnel believe they have particular expertise to contribute. The involvement by utilities in energy and environmental issues and the involvement of banks in housing and neighborhood development programs are examples of this rationale.

On the other hand, the general consensus of the participants at The Conference Board's Community and Public Issues Council meeting was that, for the most part, the community affairs executives determine the area of company involvement—influenced by experience and the judgment of top corporate leadership. However, these determinations have also been shaped by many others with whom the executive interacts—peers, community contacts, co-workers, "gurus," and by the company culture and tradition.[4]

Issues Of Concern

Local economic development is the leading issue of concern, and the one that generates the most involvement. A traditional concern for most businesses, it is an issue that often governs the economic climate and helps to determine whether or not a company prospers. Local economic development was selected first in the cumulative rating, with 47 percent of the total mentions.

Primary and secondary education was the second most frequent involvement issue, chosen by 42 percent of the respondents on a cumulative basis.

Third was the broad area of *health care and hospitals*, including the issue of health care costs. About 36 percent of the cumulative mentions were for this issue.

The fourth issue was *unemployment and job training* with 34 percent of the cumulative mentions. Fifth was *arts and culture* with 32 percent of total choices.

Other issues that garnered more than 30 percent of the total mentions were *higher education* (31 percent) and *minority concerns* (30 percent). Table 1 presents all the issues and the frequency of mention.

In the "other" category, the most frequently mentioned involvements dealt with the problem of hunger and support for programs that feed the hungry in the community in which the company has its headquarters. A second involvement was with United Way. No attempt was made to find out whether the local United Way program was a community "issue," or just another involvement of companies that mentioned it.

Table 1: Community Issues of Concern to Corporations

Issues	*Percent of Mentions*
Local economic development	47%
Primary and secondary education	42
Health care, hospitals	36
Unemployment, job training	34
Arts and culture	32
Higher education	31
Minority concerns	30
Downtown revitalization	28
Youth programs	21
Environment, conservation, energy	20
Aging and retired persons	17
Day care and family services	17
Local government and public services	17
Housing	16
Neighborhood development	15
Drug and alcohol abuse	13
Infrastructure (streets, bridges, etc.)	13
Transit and transportation	12
Public safety and crime	9
Adult literacy	8
Handicapped	6
Women's concerns	3
Parks and recreation	2
Other (each less than 2%)	22

Using the remaining method of computation, the top five community issues were ranked by level of company involvement, i.e., by the number of times each issue was mentioned as the one getting the most company attention, or second highest amount of attention, etc. *Local economic development* was most often named the issue getting top attention, and, therefore, was first choice. It was also the third-choice issue. *Primary and secondary education* was the second most important issue mentioned by the largest number of respondents. It is interesting to note also that some of the less "popular" issues, as far as total mentions go—notably *youth programs* and *day care and family services*—scored high as fourth and fifth choices (Table 2).

Table 2: Top Five Community Issues (by ranking)

Issues	*Choices*				
	1st	*2nd*	*3rd*	*4th*	*5th*
Local economic development	1	4	1		
Primary and secondary education	2	1	4		2
Health care and hospitals	3		2	3	
Arts and culture		3	5	4	
Unemployment, job training		2		1	5
Minority concerns		5	3		3
Youth programs				1	
Higher education	4			4	
Downtown revitalization	5		5		
Day care and family services			2		

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[4] Kathryn Troy, *Studying and Addressing Community Needs: A Corporate Case Book*. The Conference Board, Report No. 866, 1985.

Choices By Industry

Because of the heavier response from manufacturing companies, the survey responses were separated and analyzed according to particular industry categories in order to highlight the differences or similarities in interest. For the manufacturing industries, the major concerns, in order of significance, were: local economic development, health care issues, and primary and secondary education. However, in two industries—petroleum and high technology — the companies assigned their top rankings to primary, secondary and higher education. It is probable that the need for highly trained personnel in these industries is a determining influence in these judgments.

In the financial industries, as a group, the priority involvements were local economic development and unemployment and job training (both issues received the same number of mentions), primary and secondary education and housing (with equal numbers of mentions), neighborhood development, and arts and culture. In two major types of financial businesses—banking and insurance—the choices were quite different: The key issues for the banking respondents were economic development and primary and secondary education (both of equal importance), followed by housing, unemployment and neighborhood development. For the insurance industry, unemployment was the number-one issue followed by three issues ranked equally—local economic development, arts and culture, and housing.

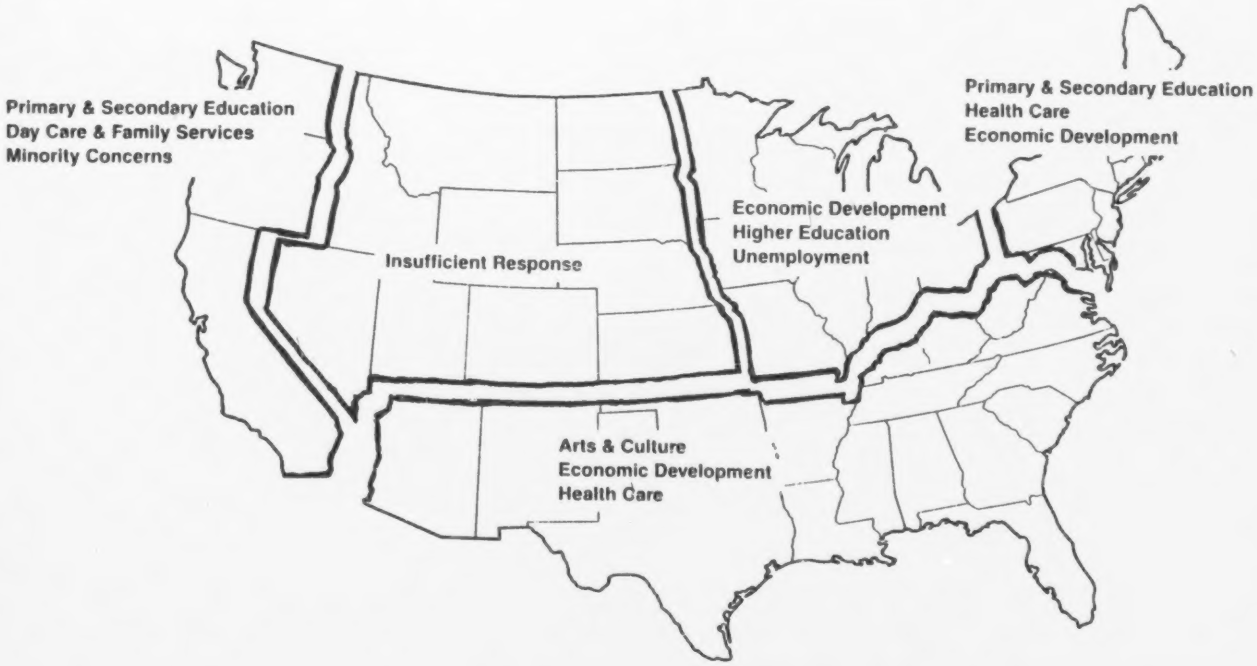
Among the service industries, including retailing, the major issues were local economic development and unemployment (both leading concerns), followed by downtown revitalization. The communications industries named primary and secondary education and youth programs as the top issues. As might be expected, community issues relating to the environment and energy were the major involvement areas for utilities, followed by local economic development and health care.

Choices By Location

Survey reports were analyzed by headquarters locations to determine whether the key issues might reflect regional characteristics. Interesting differences were found, reflecting major regional economic and social conditions. (See chart.) The deep concern over the loss of industry in the Middle West was reflected in the choices made by companies in that area. The extensive public education improvement efforts ongoing in the Northeast and in California are mirrored by the corporate priority given this issue in these regions.

In considering the community-affairs program choices made by companies, another factor is the effect of being headquartered in major urban centers. The community issues for such firms may reflect the problems of the inner-city minority

Community Concerns, By Region



population, but not, the study respondents indicate, to the extent that they outweigh all other issues: Minority issues were not among the top three concerns. The leading issues identified by those inner-city companies were:

(1) Primary and secondary education
(2) Local economic development
(3) Unemployment and job training
(4) Health care and minority concerns (same number of mentions)
(5) Arts and culture.

Community Issues of Secondary Concern

There are community issues in which businesses have a significant interest but have had little or no actual local involvement. The cumulative rankings showed the most frequently mentioned to be concerns with local infrastructure (streets, bridges, sewers, etc.), transit, housing, adult literacy, day care and family services, and public safety. In all of these, the view is that program responsibility and funding belongs primarily to local public and nonprofit sectors rather than to the business sector. On two of the issues, day care and family services and adult literacy, perceived demographic changes are generating a trend toward more corporate involvement.[5]

Trends in Corporate Concerns

Only primary and secondary education, among the leading issues in which corporations are involved, was identified as clearly a rising issue. The rest were considered to be rather constant; none of the issues weighed was judged to be on the decline as a matter of corporate concern.

The latter view was reinforced by responses to a request to identify those issues that would be prime areas of corporate involvement in the next two to five years—although they may not be major issues currently. Among those identified, primary and secondary education was the first, problems of the aging was second, and health care and hospitals was third in frequency of mention. The fourth and fifth items—higher education and unemployment each received the same number of mentions.

Issues and Responses

Part of the interest in identifying the leading issues is in learning where impetus for corporate involvement arose, and in the kind of response this type of issue has generated.

Local Economic Development

Local economic development has been a long-continuing concern for most businesses. It is important to maintain a good business climate in the community, to attract new businesses, to encourage expansion at present locations, and to create new kinds of stimuli for the local economy (for example, by boosting convention and tourist activities). In addition, tax revenues from business help to finance schools, infrastructure, transit, and all other local services.

Local economic development has been the basic program of chambers of commerce and other local business organizations, and is an issue in which they have assumed leadership. In recent years, however, other public and private efforts in this area have grown, some in the form of partnerships to strengthen local job-development efforts.[6]

The impetus for involvement in this issue has come primarily from business organizations: This activity remains the raison d'etre for many such organizations. Within the corporation, involvement has been encouraged by the CEO and other "networking" executives—usually public affairs officers who represent the company in the business organizations. Aside from supporting the efforts of other organizations, the major responses of local businesses have been to provide leadership in communitywide programs; to make financial contributions, to provide technical assistance; to participate in partnerships and coalitions; and to support legislation, such as industrial revenue bonds and financial and tax incentives, that would improve the community's competitive attractiveness to new business.

Primary and Secondary Education

As already noted, this is the rising issue of concern to the business community, although it has been a recognized problem in most communities for decades. The extensive public attention given to educational problems in the last few years has done much to heighten business concern. Earlier corporate involvement by companies in education was associated with the personnel or human resources function. This new attention—coming from the community affairs officers and stimulated by new relationships with school leadership—has also involved top management to an increasing degree. This issue is third on the list of community issues that attract CEO involvement.

While this issue is important to most companies because it has a bearing upon the quality of the work force, the greatest number of respondents described their companies' involvement: first, as a responsible act for the company; second, as a company tradition or commitment; and only third as an interest in better-prepared employees.

Company programs include financial contributions, involvement in partnerships or coalitions, in-kind contributions, providing community leadership, providing management and technical assistance, and extending volunteer assistance.

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[5] Helen Axel, *Corporations and Families: Changing Practices and Perspectives.* The Conference Board, Report No. 868, 1985; and Dana Friedman, *Corporate Financial Assistance for Child Care.* The Conference Board, Research Bulletin No. 177, 1985.

[6] Leonard Lund and Linda Wintner, *The Public-Private Partnership in Action.* The Conference Board, Information Bulletin No. 67, 1979; R. Scott Fosler & Renee Berger, *Public-Private Partnership In American Cities.* Lexington MA: D.C.Heath Company, 1982.

Adopt-a-school programs are the most prevalent form of business-school partnerships, but they vary greatly in the degree of corporate involvement. As noted by current experiences in California, Minnesota, North Carolina, Georgia and other states, businesses involved with this issue are becoming more concerned with policy aspects of the problem: They have begun to take a more prominent role in urging passage of school-improvement legislation.

Health Care

Of all the major issues, the concern for the cost of health care has had the most immediate impact upon business operations. This may account for the extent of involvement of CEO and human resource executives. Reasons given for company involvement are: first, that it is a responsible act for the company; and, second, that it is of economic benefit to the company. Because this is a difficult issue for companies to address individually, most of the corporate reaction has come in support of the efforts of coalitions and policy-development organizations. Thus, making financial contributions and providing community leadership are the key responses. A third response is a revision of company practices—in this instance, restructuring of the company's health benefits program.

Unemployment, Job Training

The fourth-ranked issue is the traditional business concern for keeping the local labor force employed and measures to deal with problems of the hard to employ. While Federal Government programs have been the prime support of job-training activities, the involvement of business increased measurably with the creation of Private Industry Councils (PIC's), the local job-training organizations created by the Job Training Partnership Act of 1982. Members of the PIC's most often include corporate executives—key executives in public affairs and human resources—together with the owners of small businesses.

Aside from the involvement in Private Industry Councils, most major businesses also have supported other organized job-training efforts aimed at providing employment for youth and minorities or, in some cases, have conducted their own programs in which involvement translates into financial support and leadership. A third major response is the revision of company hiring practices to increase opportunities for the hard to employ. The principal reasons given for company involvement are that it is important for the local economy, a responsible act for the company, and the kind of activity urged by community and business leadership on both the local and national levels.

Arts and Culture

Local business leaders traditionally have played a prominent role in the promotion of the arts, providing leadership as well as financial support. In the companies in this survey, the chief executive officers' choice of such involvement for themselves was second only to their promotion of local economic development. Involvement in this issue is valued not only for the distinction it accords to the individual, but also for the public relations value it brings to the company. For the cultural institution, it has the advantage of making available the time and efforts of affluent and influential local personalities—as well as the financial support they represent.

Increasingly, the role of such institutions in the enhancement of the quality of life has become a major asset in marketing the community as a location for new business. Such recognition and the economic benefits of the arts as an industry, as well as a magnet for the tourist and convention trade, has led to increased efforts in major communities to encourage the establishment of regional theaters, dance companies, art galleries, and similar institutions.

Business support, as noted before, has come principally in the form of financial contributions, and in leadership support. Additionally, there has been assistance in the management of institutions and in the availability of volunteers. Company involvement is attributed to a continuation of a company tradition in support of the arts, to the enhancement of company image, and to the view that it is a responsible act for the company.

Other Corporate Responses

Sometimes corporate responses depend upon what company resources can be offered by the community affairs officer. In the informal survey held in connection with the Community and Public Issues Council meeting, community affairs officers responded that they could freely commit financial contributions (with upper limits ranging from $500 to $10,000), make in-kind contributions, and offer their own time. To a lesser degree, they could provide for advice and technical assistance, set up programs for volunteers, and call upon some top management involvement.

Some business response to local issues is taking new forms. Aside from participation as a member in programs run by business organizations, individual companies have begun to adopt multi-tier responses—as individual companies and as members of other coalitions, partnerships and corporate peer groups. This kind of involvement is being pursued to give the company more visibility, more control over programming, and the opportunity to develop personal and organizational relationships. In some instances, it can also provide for coordination of several company programs. These kinds of multiple relationships are currently evident in business-school partnerships. Many companies are involved in adopt-a-school programs as individual companies and, at the same time, are part of a local business-education consortium addressing general efforts to improve education.

Assessing Corporate Involvement

Most of the impetus for corporate involvement in community issues comes from a few sources. Within the corporation,

Texaco's Innovative Involvement in Westchester

Texaco Inc., headquartered in White Plains, New York, is a particularly good example of how a company expands and varies its community programming. On its own, Texaco conducts an adopt-a-school program. In addition, responding to requests from other companies and from schools in Westchester County, Texaco sponsored meetings between corporate representatives and school officials to examine ways to create additional business-school partnerships. The Manager of Community Relations at Texaco convinced the local Private Industry Council, on which she serves as a board member, to undertake the responsibility for administering the countywide matching of schools with businesses, since the PIC already maintains a close relationship with local schools. Fifteen new partnerships have been created in the past year and several more are being negotiated.

In addition, Texaco is represented on the Education and Arts Task Force of *Project Westchester 2000*, a long-range regional planning program involving business, government and the local citizenry. As part of its involvement, Texaco filmed a TV series for cable television on the highlights and aims of the project. The Education and Arts Task Force has set creating closer relations and continuing dialogue between businesses and schools—as exemplified by the adopt-a-school program—as its goal.

Organized by Texaco, representatives of twenty of the major corporations headquartered in Westchester County meet bimonthly to exchange information on their community affairs and public affairs programs. This regular exchange has been instrumental in helping community affairs officers of the constituent companies to enhance individual programs, and has led to cooperative involvement by groups of companies. The voluntary, and often ad hoc, associations have made it possible for community issues to be addressed far more effectively than would be possible by an individual firm on its own, and with full credit for involvement given each participant.[1]

[7] Joan S. Gilbert, unpublished remarks, Public Affairs Council meeting, Boston, MA, May 22, 1985.

it comes from those executives who interface with the community—the community affairs officers, public relations executives and, increasingly, the chief executive officer. Outside the company, the inducement most often comes from the local business organization, which maintains a continuing relationship with other organizations in the public and nonprofit sectors. Thus, in many communities, the local chamber of commerce, representing the business community, has become the vehicle for dealing with local issues, and the constituent members serve on committees and provide financial support.[7] This is the customary pattern adopted by businesses with some interest in, but no strong commitment to particular issues, or by companies without staff capability to deal with those issues. On the other hand, companies whose leaders have strong interests in an issue, either personal or proprietary, usually will fashion their own corporate response. In such cases, the company manages its own involvement and also establishes an identification with the issue in the public's mind.

A financial contribution is the most common response. A company that decides that an issue does not merit the commitment of its executives' time and talent will frequently cover its involvement with a contribution. Or this response may also indicate that some other group or organization is willing to deal with the issue and the company need do no more than provide financial assistance.

Similar assumptions may be made about the response that the company is providing "community leadership." This term denotes anything from active leadership by corporate executives to media support. Most often, it is a euphemism for support for a program conducted by another company or organization.

The most frequent reason given for corporate involvement is that it is a "responsible act" for the company. This was one of the three reasons given for involvement in every issue. Interestingly, "economic benefit to the company" was never cited as the main reason. In fact, "the impact on the local economy" was given as the reason for company involvement only for such issues as local economic development and promotion of arts and culture.

Today, most corporate community affairs officers eschew the "social responsibility" concept in favor of one emphasizing community investment or some other term that signals a relationship to the "bottom line", and have begun to substitute active roles in the promotion of programs and policies for "throwing money" at an issue. And yet it is most interesting to note that the survey respondents still state that involvement is most often motivated by the desire to be responsible, and that the response is generally financial.

In the inevitable competition for program funds, corporate community affairs officers now find that "do-goodism" does not get the same top management attention that impact on the bottom line does. This has led to an effort to alter corporate leaderships' perception that community involvement does, in fact, have real value in an economic sense, and does more than merely promote a public image (or corporate self-image) as a socially responsible institution. Inherent in this concept is the need to tie a market value to corporate involvement—a value translatable as accumulated good will that would work in the company's favor. For instance, some public affairs analysts believe that some of the credit for Johnson and Johnson's ability to overcome the Tylenol "trauma" was due to the public image of the company as a respected and responsible corporate citizen. In other instances, prominent banks have found that their image as a socially responsible institution has had the effect of mitigating local neighborhood outcry at the closing of unprofitable branch locations. And although there are countless other examples of good will or "brownie points" accrued in a company's favor that have spared it costly litigation or regulation, community affairs officers still seek measures to set values to these experiences.

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[7] Lund, 1985, p.9-11.

Some of these changing perceptions are found in major companies in which the community affairs function already has been linked to company policy and goals, and also where there has been active involvement by top management in community affairs. As we periodically reassess corporate involvement in community issues, one of the interesting aspects will be to note the rate at which these altered perceptions gain general acceptance.

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